

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM)
FOR REGULATING RATES AND CLASSES) Docket No. RM2017-3
FOR MARKET DOMINANT PRODUCTS)

**COMMENTS OF ALLIANCE OF NONPROFIT MAILERS,
AMERICAN CATALOG MAILERS ASSOCIATION, INC.,
ASSOCIATION FOR POSTAL COMMERCE,
IDEALLIANCE AND
MPA—THE ASSOCIATION OF MAGAZINE MEDIA**

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SUMMARY OF COMMENTS

This case illustrates the havoc that can result from construing a complex statute by focusing on one provision in isolation instead of reading the statute as a whole.

39 U.S.C. § 3622(d)(3) requires the Commission, in conducting its 10-year review of the “system” for regulating market dominant rates established by the Commission in 2007, to apply “each” of the ratemaking objectives of the PAEA “in conjunction with the others.” *Id.*, § 3622(b). Some of the objectives protect the Postal Service. In particular, Objective 5, 39 U.S.C. § 3622(b)(5), entitles the Postal Service an assurance of “adequate revenues, including retained earnings, to maintain financial stability.” “Adequate” means sufficient to “maintain high quality services” as defined under Section 3691. But other objectives protect mailers. In particular, Objective 1 requires the system of regulation to “maximize incentives to reduce costs and increase efficiency.” Objective 2 calls for “stability in rates.” And Objective 8, like 39 U.S.C. § 404(b), directs the Commission to “establish and maintain a just and reasonable schedule for rates and classifications.” Finally, 39 U.S.C. § 3622(d), with a few exceptions not relevant here, imposes a statutory constraint on rate increases that trumps any of the objectives of § 3622(b): rate increases for any market-dominant class may not exceed increases in the Consumer Price Index.

In Order No. 4258, however, the Commission has reduced this structure to a one-dimensional caricature. The order adopts an expansive definition of revenue adequacy, elevates it to the supreme regulatory objective, and effectively writes out of the statute the objectives of PAEA that promote

efficiency and protect mailers. The result is a series of above-CPI rate increases whose magnitude is unprecedented in the annals of incentive ratemaking. Assuming annual inflation of two percent, for example, the proposed alternative system would impose rate increases over five years as high as *40 percent* on Periodicals Mail and Marketing Mail Flats and *28 percent* for other Market-Dominant products.

These staggering increases are unlawful in several respects.

(1)

The Commission may not authorize above-CPI rate increases under Section 3622(d)(3). Section 3622(d)(1) and (2) forbid class-average rate increases that exceed the growth in the CPI, except in limited circumstances not relevant here. Section 3622(d)(3), which authorizes the Commission to modify or replace the “system” for regulating market-dominant rates, does not override Sections 3622(d)(1) and (2). The modified or new “system” that Section 3622(d)(3) authorizes the Commission to adopt, like the initial “system” that Section 3622(a) directed the Commission to adopt, consists of the *regulations* adopted by the Commission *under* the statute, not the statute itself. As a subordinate body of rules, neither iteration of the “system” can modify the authorizing statute, which is outside of and superior to the “system.” Hence, the rulemaking authority delegated to the Commission by Sections 3622(a) and 3622(d)(3) is limited by the binding statutory constraints that Congress codified in Section 3622, including the CPI-based price cap (Section 3622(d)) and the restrictions on worksharing discounts (Section 3622(e)).

(2)

Even if (contrary to fact) Section 3622(d)(3) empowered the Commission to abrogate the CPI cap, the alternative regulatory system proposed in Order No. 4258 would still be unlawful because it would violate several important objectives of Section 3622(b) meant to protect captive mailers.

(a) The proposed alternative system would violate Objective 1, maximizing incentives to reduce cost and increase efficiency. Index ratemaking encourages a regulated monopoly to operate efficiently by promising greater profits if the firm achieves above-average productivity gains, and lower profits (or losses) if the firm fails to do so. Showering the Postal Service with an extra \$16 to \$24 billion of revenue over the next five years, most of it unconditioned on any required showing of efficiency or productivity gains, would weaken, not maximize, incentives for efficiency and cost control.

The Commission's counterargument—that more money will mean greater efficiency by alleviating the shortage of investment capital that supposedly prevents the Postal Service from operating more efficiently—founders on several grounds. First, the *ability* to invest in efficiency is distinct from the *incentive* to do so. Objective 1 focuses on the latter, and the Commission cannot evade it by conflating the two issues, or simply assuming that more retained earnings will automatically translate into greater and more effective investment on efficiency.

Second, the “harmonious cycle” of investment hypothesized by the Commission is unsupported speculation. The Postal Service has funds to make investments. It made capital investments in efficiency and cost reduction

between 1971 and 2007, when the Postal Reorganization Act imposed a breakeven requirement. Today, 11 years after PAEA became law, the Postal Service boasts cash reserves that exceed \$10 billion, and generates about \$3 billion in additional cash from operations each year. This is unsurprising: a firm that is mature or shrinking can generate sufficient cash to pay for needed investments if the firm's revenue covers the firm's accrued operating costs, including non-cash depreciation expenses.

Third, the Commission has failed to identify, let alone quantify, the likely return on the additional investments that the Postal Service supposedly would make if it enjoyed higher earnings. Indeed, the Commission could not perform such an analysis, for it refused to allow discovery of any of the relevant data and analyses from the Postal Service.

Fourth, the performance of the Postal Service and its European counterparts in the past few years, when enforcement of index ratemaking has slackened, foreshadows how the proposed above-CPI surcharges would undermine the Postal Service's incentive to lower costs and increase efficiency.

Fifth, the 0.75 percent surcharge proposed for maintaining recent rates of productivity growth would not cure the violation of Objective 1. Any incentive provided by this surcharge would be outweighed by the windfall the Postal Service would still receive from the across-the-board surcharge of two percentage points, the approximately two additional percentage points of surcharges authorized for "noncompensatory" products and classes, and the additional surcharge of 0.25 percentage points offered for maintaining nominal service performance standards at their current level. The Postal Service would

receive this entire windfall automatically, without any obligation to improve productivity or reduce costs. We are unaware of any precedent for allowing a regulated monopoly to collect above-normal earnings merely for maintaining existing productivity trends, let alone those as meager as the Postal Service has achieved in recent years. Forcing captive mailers to pay the Postal Service a matching grant here is completely unwarranted.

(b) The proposed alternative system would violate Objective 2 (rate stability). This flaw cannot be evaded by redefining rate stability as rate *predictability*. As the Commission has repeatedly found, “rate stability” in this context means the absence of any real (*i.e.*, inflation adjusted) price increases. Rates that increase on average measurably faster than inflation are not stable in this sense even if the magnitude and timing of the increases are predictable. The increases proposed by the Commission—as much as 30 percent above inflation over five years, and as much as 40 percent in nominal terms—would massively violate Objective 2.

(c) The Commission’s proposals would also violate Objective 8 and 39 U.S.C. § 404(b), which require the establishment of “just and reasonable” (or “reasonable and equitable”) rates and classifications. This standard requires, among other things, that captive ratepayers be protected from having to pay for needlessly high costs or needlessly low efficiency. The massive rate increases that Order No. 4258 would allow, unconditioned on any requirement that the Postal Service first control its excess costs, would not be just, reasonable or equitable. Although the mailers raised the issue at length in their Phase I comments, Order No. 4258 ignores it.

(d) The Commission's analysis of Objective 5 (revenue adequacy or financial stability) is also flawed. The Commission has improperly elevated financial stability over the other objectives of Section 3622(b). But the proposed system would be unjustified by Objective 5 even if it could properly trump the other objectives. The Postal Service has achieved short-term financial stability, and the Postal Service's longer-term financial prospects are much brighter than the Commission portrays.

In particular, the Commission's proposal ignores that the contribution from competitive products, mainly package delivery, is growing by an average of \$1 billion per year. A rational analysis of the putative shortfall in contribution that the Postal Service allegedly needs to recover from market-dominant products must consider the anticipated contribution from competitive products, since both sets of products contribute to institutional costs. Correcting this omission single-handedly refutes the Commission's shortfall analysis: the likely five-year growth in contribution from competitive products by itself equals the extra contribution that the Commission projects the Postal Service needs to break even over the same period.

The Commission's analysis of the Postal Service's obligations to its retirees is also unsound. The red ink on the Postal Service's financial statements is largely an artifact of the Postal Service's failure to meet the unrealistic prefunding schedule enacted in PAEA. But neither Congress nor the Administration have moved to enforce the schedule. In reality, the Postal Service's retiree benefit plans are extraordinarily well funded by comparison

with most private sector plans and nearly all other federal, state and local government plans.

The undersigned parties' comments in Phase I identified other steps that the Postal Service could take to improve its finances. Some of the most promising and potentially lucrative steps do not require legislation. The Commission has failed to discuss any of these options in Order Nos. 4257 and 4258.

The Commission's shortfall analysis suffers from another, equally significant failure of proof: the gross shortfall amount assumed by the Commission is unsupported by a reliable projection of the Postal Service's future revenue needs.

Finally, even if the Postal Service needed more money, the proposed extra surcharges would be unlikely to provide it. The gain in unit contribution would likely be offset by a drop in mail volume.

(e) The radical rate increases proposed by the Commission cannot be justified by invoking Objective 3, the objective of "maintain[ing] high quality service standards established under section 3691." 39 U.S.C. § 3622(b)(3) (citing 39 U.S.C. § 3691). The value of high quality service is determined not in a vacuum, but through a cost-benefit analysis that balances the benefits of faster and more reliable service against the costs of providing it. Order No. 4258 provides no such analysis. Without it, there is no basis for finding that current service standards or actual service performance are too low.

The 0.25 percentage surcharge proposed for market-dominant mail if the Postal Service maintains its current service performance standards is unjustified for other reasons as well. The award is contingent on maintaining published (or nominal) service standards. There is no requirement that the published standards improve over time. There is no requirement that the actual service performance live up to the nominal standards. And there is no requirement that the Postal Service reduce its costs at all. The Postal Service gets to collect the surcharge regardless.

(3)

The extra surcharges of two percentage points or more proposed for “non-compensatory” products and classes—mainly Periodicals Mail and Marketing Mail Flats—are unlawful as well. The losses experienced by the Postal Service are its own responsibility. During the past decade, the efficiency with which the Postal Service has handled flat-shaped mail has declined greatly. As a result, the Postal Service’s costs of sorting, transporting and delivering flats are much higher than if the Postal Service had just maintained the same productivity levels for flat-shaped mail as when PAEA was enacted.

The main causes of this abysmal performance are Postal Service management errors. The first is the failure to scale down Postal Service operations and costs in tandem with the decline in its volume and workload in recent years. The second is the Postal Service’s obstinate refusal to abandon the Flats Sequencing System (“FSS”) despite repeated warnings, from within the Postal Service and from mailers of flats, that the FSS was an economic disaster in the making. A third error is the deliberate mispricing of Carrier

Route Basic flats, which needlessly deters mailers from engaging in an efficient amount of worksharing. Correcting these unforced errors would virtually eliminate the shortfall between revenue and Postal Service attributable costs. Hence, trying to eliminate the shortfall through extra above-CPI charges on “noncompensatory” products would violate Objective 1, as well as other provisions of PAEA.

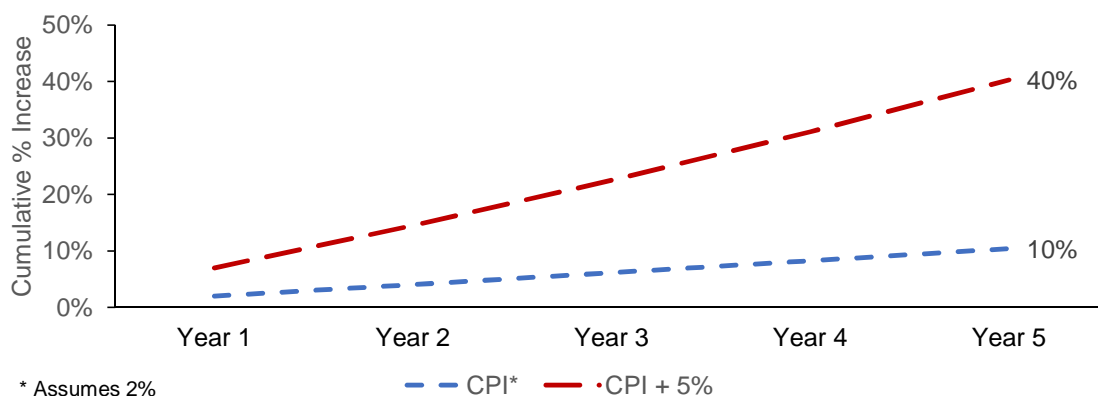
Finally, Outside County Carrier Route mail, despite the management errors discussed in these comments, covers its attributable costs even today. Hence, even if (contrary to fact) a “noncompensatory” product surcharge were somehow warranted for other kinds of Periodicals Mail, no surcharge would be appropriate for Outside County Carrier Route.

COMMENTS

I. THE ALTERNATIVE REGULATORY SYSTEM PROPOSED IN ORDER NO. 4258 IS UNLAWFUL BECAUSE § 3622(d)(3) DOES NOT AUTHORIZE THE COMMISSION TO BREACH THE CPI CAP.

A threshold and fatal objection to the Commission’s proposals in Order No. 4258 is their *ultra vires* character. The proposals would subject all market-dominant mail to sizeable above-inflation rate increases. Some products and classes, including Periodicals Mail and Marketing Mail Flats, would face annual rate increases of as much as five percentage points above inflation. The cumulative five-year rate increase for those products would be as much as 40 percent, or 30 percentage points above inflation:

Figure 1. Comparison of PRC-Proposed Periodicals Rate Increase With Inflation



Source: Library Reference ANM *et al.*—LR—RM2017-3/4, “Figure 1.”

A system of regulation that would allow the Postal Service to increase its rates for any class by more than the annual change in the CPI-U index exceeds the Commission’s authority. As the undersigned parties explained in a letter and white paper submitted to the Commission on October 28, 2014, the text and structure of 39 U.S.C. § 3622 prohibit the Commission from making such changes to the system of ratemaking.¹ The Commission tried to refute this reasoning in Order No. 4258 (at pp. 6-20). The counterarguments are unsound, however.

As the mailers explained in their 2014 white paper, the authority conferred on the Commission by Section 3622(d)(3)—to “make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives” if the Commission determines during its 10-year review proceeding that the current

¹ The white paper is appended to these comments as Appendix A and incorporated herein by reference.

system of ratemaking is not achieving the objectives of PAEA—does not empower the Commission to allow price increases that violate 39 U.S.C. § 3622(d)(1). That provision requires that the system of regulation “shall” prevent rate increases greater than “the change in the [CPI-U] unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates.” 39 U.S.C. § 3622(d)(1). Section 3622(d)(1) also requires that the system of regulation “shall” include provisions that prevent the Postal Service from adjusting rates “in excess of the [CPI-U] limitations.”

The mandatory effect of this language is unambiguous. Whatever modified or new ratemaking system the Commission might make, that system is subordinate to the CPI cap. The “Requirements” of the system of ratemaking are, indeed, required elements of the system of ratemaking. Where the statute states the system “shall” contain certain elements, including “an annual limitation on the percentage changes in rates . . . equal to the change in the Consumer Price Index for All Urban Consumers,” it means the system “shall” contain these elements.

This conclusion is underscored by the division of labor prescribed by the statute. Nowhere in PAEA did Congress itself establish a “system” of ratemaking. Congress delegated that task to the Commission. Section 3622(a) directs *the Commission* to “establish . . . a modern system for regulating rates and classes for market-dominant products.” The rest of Section 3622 lays out the features the system established by the Commission must incorporate. Section 3622(b) lists nine objectives that “[s]uch system shall be designed to

achieve”; Section 3622(c) identifies 14 factors the Commission must take into account “[i]n establishing or revising such system”; and Section 3622(d) lists “Requirements” that “[t]he system for regulating rates and classes for market-dominant products shall” include or establish. Within the bounds drawn by Sections 3622(d) and (e),² Congress gave the Commission broad discretion to construct via rulemaking a “system” for regulating rates. But nothing in Section 3622 (or in PAEA generally) authorized the Commission to modify, eliminate, or replace any part of the statute itself.³

Section 3622(d)(3) calls for the same division of labor. The provision directs the Commission to review, and allows it to modify or replace, “the system for regulating rates and classes for market-dominant products established under this section”—*i.e.*, the same interstitial implementing rules that Section 3622(a) required the Commission to “establish.” Section 3622(d)(3) does not authorize the Commission to review, modify or replace the

² The statute also includes provisions in Section 3622(e) governing workshare discounts, but it does not contain direction to the Commission regarding how to incorporate these provisions into the “system.” Rather, these are statutory provisions that are superior to, and govern regardless of, the “system” of rules that the Commission establishes under the statute.

The proposed rule changes for worksharing discount differ from the proposed above-CPI rate increases in one important respect: the Commission can make the changes to the worksharing regulations proposed in Order No. 4258 without violating Section 3622(e), so long as the Commission continues to honor the statutory exceptions applying to passthroughs that exceed 100%.

³ The Postal Service’s statement that Section 3622(d) “plainly states at the outset that its provisions are part of the ‘system for regulating rates and classes for market-dominant products’” (USPS Comments at 19; Order No. 4258 at 9) is untrue. The statute does not state this anywhere.

statutory framework itself. The language describing the “system” in Section 3622(d)(3) is nearly identical to the language of Section 3622(a), which directs the Commission to “establish . . . a modern system for regulating rates and classes for market-dominant products.” The “system” referred to in Section 3622(d)(3) can only be the “system” established pursuant to 3622(a). In other words, it is the rules—or “system”—established by the Commission to implement PAEA that are being reviewed, not PAEA itself, including its CPI cap requirement. Construing each appearance of the term “system” in Section 3622 to refer to the system of regulation established by Commission rulemaking *except when* the term appears in subsection 3622(d)(3) is a nonsensical construction. A word or phrase that appears in two or more provisions of the same section of a statute is presumed to have the same meaning each time. *Mohasco Corp. v. Silver*, 447 U.S. 807 (1980). “[T]here is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning.” *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

The Commission has repeatedly recognized the central importance and binding character of the CPI cap. When promulgating the modern system of ratemaking in Docket RM2007-1, the Commission read Congress’ words as they were written, acknowledging that Section 3622(d) “addresses some of the **mandatory** features that the Commission **must** include in the modern regulatory system.” Docket No. RM2007-1, *Regulations Establishing System of Ratemaking*, Order No. 26 (Aug. 15, 2007) at 7 (emphasis added).

The Commission likewise stated in 2010:

Quantitative pricing standards are at the top of the statutory hierarchy. Next in the hierarchy are the qualitative “objectives” listed in section 3622(b), followed by the qualitative “factors” listed in section 3622(c). Under this hierarchy, violations of the three quantitative pricing requirements are “out of bounds.” The Postal Service has broad flexibility to develop prices to achieve the qualitative objectives and factors of section 3622(b) and (c) *so long as its prices are “in bounds” because they satisfy these quantitative requirements.*

Docket No. RM2009-3, *Consideration of Workshare Discount Rate Design*, Order No. 536 (Sept. 14, 2010) at 16–17, 35–36 (emphasis added); *USPS v. PRC*, 676 F.3d 1105, 1108 (D.C. Cir. 2012), *on remand*, Order No. 1427 at 17–19.

Similarly, in the first exigent rate case, the Commission characterized the role of the CPI cap in the statutory hierarchy as absolute, “central,” and “indisputable,” and the Commission’s role vis-à-vis the “system for regulating rates and classes” as secondary and interstitial. Order No. 547 in Docket No. R2010-4, *Rate Adjustment Due to Extraordinary or Exceptional Circumstances* (Sept. 30, 2010) at 10–13, 49–50. PAEA, the Commission explained, had replaced the break-even mandate of the Postal Reorganization Act with the CPI cap as the main safeguard for captive mailers. *Id.* “PAEA removed any reference to cost-of-service regulation, establishing the price cap as the *only regulatory model to be used under the new rate system.*” *Id.* at 10 (emphasis added). “The broad flexibility” in pricing otherwise allowed the Postal Service by PAEA “underscores the importance of the price cap as a protection mechanism for ratepayers.” *Id.* at 12. “The price cap . . . stands as the single most important safeguard for mailers.” *Id.* at 13. The “role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the

incentive to reduce costs is to remain effective. Therefore, *it would undermine the basic regulatory approach of the PAEA if the Postal Service could pierce the price cap routinely.*” *Id.* at 49–50 (emphasis added).

The Commission reaffirmed this position on remand from the D.C. Circuit:

Key policies underlying the PAEA include efficiency and cost control. The PAEA permits the Postal Service to retain earnings that may be distributed as incentives to management and employees. [H.R. Rep. No. 109-66] at 43-44. The PAEA, however, precludes the Postal Service from recovering losses by increasing rates above the price cap without the Commission’s approval. *Id.*

The price cap plays the central role in implementing the purposes and policies of the PAEA. The price cap incents the Postal Service to improve efficiency and reduce its costs and serves as the primary source of discipline over the Postal Service’s expenses. Order No. 547 at 38, 64. It also maintains “adequate financial safeguards and incentives for cost control” and acts as the single most important safeguard for mailers by providing rate stability and predictability. Senate Report at 10; Order No. 547 at 12.

Order No. 864 in Docket No. R2010-4R, *Rate Adjustment Due to Extraordinary or Exceptional Circumstances* (Sept. 20, 2011) at 32–33 (emphasis added).

In Order No. 4258, however, the Commission offers several reasons for abandoning this position in the 10-year review:

- (1) Differences between the wording of Sections 3622(a) and 3622(d)(3) imply that the Commission may adopt in the 10-year review any alternative system that disregards the CPI cap.

- (2) Differences between the wording of Section 3622(c)(4) and 3622(d)(3) likewise imply that the Commission may adopt an alternative system of regulation that disregards the CPI cap.
- (3) The title of Section 3622(d)—“Requirements”—cannot alter the text of the statute.
- (4) The legislative history of PAEA, including a floor statement by Senator Susan Collins, confirms that Section 3622(d)(3) allows the Commission to revoke Section 3622(d)(1) in the 10-year review.
- (5) The Commission’s prior statements concerning the binding effect of the CPI cap apply only to the system of regulation initially established under Section 3622(a), and not the adoption of an alternative system under Section 3622(d)(3).

These counterarguments are unfounded. We respond to each one in turn.

A. Differences between the wording of Sections 3622(a) and 3622(d)(3) do not authorize the Commission to disregard the CPI cap.

The Commission offers three textual arguments for treating Section 3622(d)(1) and (2) as inapplicable in the 10-year review proceeding. None are well-founded.

(1) The Commission asserts that, because Section 3622(a) merely authorized the Commission to “establish” or “revise” a system of regulation, but Section 3622(d)(3) allows the Commission either to “modify” the system *or*

replace it with an “alternative system,” the “disjunctive” character of the latter choice of remedies implies that Section 3622(d)(3) allows the Commission to ignore Section 3622(d)(1). This reasoning has two flaws.

First, the Commission reads too much into the differences between “revise,” “modify,” and adopt an “alternative system.” In fact, “revise” and “modify” are synonymous in this context, and adopting an “alternative” system is a way to “revise” or “modify” the original system. See “Revise,” <https://ahdictionary.com> (Am. Heritage 5th ed.), *retrieved on* Feb. 23, 2018 (defined as “to reconsider and change or modify”); *see also Application of Diamond State Tel. Co.*, 113 A.2d 437, 444–45 (Del. 1955) (in rate proceeding, noting that “revise” and “modify” mean “change, to alter, to amend or to reduce” and rejecting suggestion that “revise” is broader than “modify.”).

Second, even if there were a meaningful difference between the option to “make . . . modification to” and the option to “adopt [an] alternative system,” neither option would allow the Commission to ignore the “Requirements” of Section 3622(d). Even an “alternative system” must still be a “system.” “System,” as explained above, refers to the Commission’s implementing rules, not the authorizing statute, including the “Requirements” of Section 3622(d).⁴

⁴ In his supplemental views on Order No. 4257, Commissioner Hammond recognizes that “the system” could refer to “the rules and regulations adopted by the Commission to implement the price cap.” Order No. 4257, Supplemental Views of Commissioner Tony Hammond at 1. While Commissioner Hammond also states that “the system” could also refer to “the price cap framework set forth in section 3622,” a proposition with which we disagree, he is correct that if there is any ambiguity in the phrase, “it is important to consider both” meanings. The Commission’s decision in Order No. 4257 and its proposal in Order No. 4258 would be overturned on review for failing to consider the

The Commission cannot replace the *statutory* “system” because no such “system” exists. Hence, even wholesale “replacement of the existing system” cannot entail replacement of the provisions of Sections 3622(d)(1) and (2) that make the CPI cap binding.⁵

(2) The Commission argues the ten-year review must be deemed to include authority to modify or eliminate the statutory CPI cap because section 3622(b) “provides that the system ‘shall be designed to achieve’” the objectives. Order No. 4258 at 15. The premise of this argument is unexceptionable, but the Commission’s conclusion does not follow. No one disputes that both the original “system” and any modified or alternative system should be “designed to achieve” the objectives of Section 3622(b). But the objectives are themselves bounded by the requirements of Section 3622(d). As noted above, the Commission has repeatedly held that the “objectives” of § 3622(b) cannot trump those requirements, including the CPI-based price cap. *See* pp. 13-15, *supra* (citing Commission decisions). Hence, the requirement that an alternative system of regulation comply with Section 3622(d) is subsumed in

alternative that “the system” refers to the rules established by the Commission. Either the plain language dictates this reading, in which case the Commission’s interpretation fails under *Chevron* step one, or the Commission has failed to recognize the ambiguity in the language and interpret the statute accordingly under *Chevron* step two. *USPS v. PRC*, 640 F.3d 1263, 1268 (D.C. Cir. 2011) (“Exigency I”).

⁵ As *ANM et al.* explained in their March 2017 Comments, Congress could not constitutionally delegate to the Commission the authority to rewrite the statute as the Commission has proposed. *See, e.g., Clinton v. State of New York*, 524 U.S. 417, 438–99 (1998); *Panama Ref. Co. v. Ryan*, 293 U.S. 388 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

the requirement that an alternative system of regulation must be “designed to achieve” the objectives of Section 3622(b).

(3) The Commission argues that, because Section 3622(d)(3) requires the Commission to conduct a formal review of the system before modifying the system or adopting an alternative, those remedies must differ from the Section 3622(a) remedies of reviewing and revising the system on the Commission’s own initiative. Order No. 4258 at 16–17. This is another *non sequitur*. A more natural reading is that the 10-year review provision was included in the statute to ensure the Commission would thoroughly reassess the performance of its system at least once after the first decade. While Section 3622(a) empowers the Commission to review (and revise) more often on its own initiative, Section 3622(d) sets an outer time limit on when the first review must begin. Congress gave the Commission broad discretion over the timing and frequency of its review(s) of the system of regulation. That is a far cry from authorizing the Commission to repeal or rewrite the statute.⁶

⁶ Nor may the CPI cap be discarded on the theory that keeping it would reduce the 10-year review to an empty formality. The CPI cap leaves many compliance and implementation issues for the Commission to resolve. In Docket No. RM2007-1, the Commission considered many alternatives before settling on the system that was ultimately codified at 39 C.F.R. §§ 3010.10 through 3010.30. Docket No. RM2007-1, *Regulations Establishing System of Ratemaking*, Order No. 15 (May 17, 2007) at 2–5 (requesting comments in consideration of alternative methods for calculating CPI cap limitation and annual rate changes); *id.*, Order Nos. 26 and 27, 72 Fed. Reg. 50744 (Sept. 4, 2007) (further discussion of alternatives); *id.*, Order No. 43 (Oct. 29, 2007) (further discussion of alternatives and adoption of final rules).

Since Order No. 43, the Commission has considered and adopted a number of other changes to the system of regulation—all within the CPI cap. *See, e.g.*, Order No. 303 in Docket No. RM2009-8, *Amendment to the System of*

B. Differences between the language of Sections 3622(c)(4) and 3622(d)(3) do not authorize the Commission to disregard the CPI cap.

The notion that PAEA authorizes the Commission to abandon the CPI cap in the 10-year review proceeding likewise finds no support in the differences in wording between Sections 3622(c)(4) and 3622(d)(3). *Cf.* Order No. 4258 at 15. The Commission reasons that, because Section 3622(c)(4) expressly restricts the “alternative means of sending and receiving [mail] at reasonable costs” to alternatives that are “available,” but Section 3622(d)(3) contains no restriction on any “alternative system” of regulation that the Commission might adopt (other than the requirement that the changes must be “necessary to achieve the objectives” of Section 3622(b)), the absence of such a restriction in Section 3622(d)(3) implies that the terms of the alternative systems open to adoption in the 10-year review proceeding are otherwise unrestricted. *Id.*

This logic is fallacious. The argument is an appeal to the negative-implication canon of construction, also known as *expressio unius est exclusio alterius*. “‘The force of any negative implication, however, depends on context.’ The *expressio unius* canon applies only when ‘circumstances support[] a sensible inference that the term left out must have been meant to be excluded.’” *NLRB v. SW General, Inc.*, 137 S. Ct. 929, 940 (2017) (citations omitted). In

Ratemaking Regulations (Sept. 22, 2009); Order No. 1786 in Docket No. RM2013-2, *Review of Commission’s Price Cap Rules* (July 23, 2013); Order No. 2086 in Docket No. RM2014-3, *Calculation of Percentage Change in Rates for Price Cap Purposes* (June 3, 2014); Order No. 4393 in Docket No. RM2016-6, *Rule on Motions Concerning Mail Preparation Changes* (Jan. 25, 2018).

fact, the context and circumstances of Sections 3622(c)(4) and 3622(d)(3) are quite different.

The former provision directs the Commission to account for “available alternative means of sending and receiving” mail in developing its system of ratemaking—that is, to consider competitive alternatives to the Postal Service. The use of “available” to modify “alternative means” serves to distinguish existing and useable alternatives from hypothetical competitive alternatives to Postal Service products for which the Commission need not account. This modifier serves a specific role in the context of defining this factor and directing the Commission as to its application.

By contrast, there is no reason to conclude, as the Commission does, that a lack of a similar modifier to “alternative system” within Section 3622(d)(3) itself grants the Commission unlimited discretion to develop an alternative system of ratemaking. The restriction on “alternative systems” imposed by the CPI cap appears in the two immediately preceding provisions, 3622(d)(1) and (2). Congress had no obligation to repeat the same restriction again in Section 3622(d)(3). To read Section 3622(d)(3) in isolation from the preceding parts of Section 3622(d) violates the whole-text canon, which requires that a statute must be construed as a whole, not by reading an individual provision in isolation. *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988).

C. The Commission’s obligation to maintain the CPI cap stems from the body of Section 3622(d), not just its title.

The Commission’s next argument, that the title of Section 3622(d) (“Requirements”), standing alone, cannot contravene the plain language of the

text, Order No. 4258 at 16, is an attack on a straw man. The undersigned parties have not argued that the title alone mandates the retention of a CPI-based cap. The requirement also appears in the *body* of Section 3622(d)(1): “The system for regulating rates and classes for market-dominant products shall . . . include an annual limitation . . . equal to the change in the [CPI].” The title “Requirements” summarizes in a word what the text spells out in unambiguous detail.⁷

D. Unexpressed legislative “purposes” and “intent” and the sparse legislative history of PAEA cannot override the text of Sections 3622(d)(1) and (2).

The Commission’s main argument is an appeal to legislative history. The Commission contends that “subsection (d)(3) was the result of a legislative compromise to achieve 10 years of rate stability followed by a Commission-led review of the ratemaking system and, if warranted, modification or adoption of an alternative system to achieve the PAEA’s objectives.” Order No. 4258 at 17.

This reasoning begs the question. Subsection (d)(3) no doubt was intended to authorize the Commission to review the current system of ratemaking and modify or adopt an alternative as a result. The critical

⁷ As the Commission recognizes, “[a] statute’s title can aid in resolving ambiguity.” Order No. 4258 at 16 (citing *Pa. Dept. of Corr. v. Yeskey*, 524 U.S. 206, 212 (1998)). The Commission’s further statement that a statute’s title “has no power to enlarge the text or confer powers” has no applicability to the present case. Order No. 4258 at 16. It is the Commission that is attempting to “enlarge the text or confer powers” from its reading of the statute. ANM, *et al.* are arguing that the Commission cannot ignore the plain language of the statute *restricting* its powers.

question, though, is *what provisions* the modified or alternative system still must contain—in particular, whether the modified or alternative system may jettison features that Sections 3622(d) and (e) on their face *require* the system to contain. Whatever legislative compromises culminated in the enactment of PAEA, nothing in the version of the legislation ultimately enacted authorizes the Commission to jettison in the 10-year review proceeding the requirements of Sections 3622(d)(1) and (2).

To read Section 3622(d)(3) as the Commission does, one must assume that the term “system” refers to something *different* than the “system” established by the Commission pursuant to Section 3622(a), and that this “system” is not bound by the Section 3622(d)(1)’s dictate that “[t]he system for regulating rates and classes for market dominant mail shall” include a CPI-based limitation on rate increases. Here again, the Commission reads Section 3622(d)(3) out of context. The provision did not need a self-contained restriction on the Commission’s authority over “alternative” systems in Section 3622(d)(3) because Congress had already embedded the same restriction in Sections 3622(d)(1) and (2), which require that *any* system of ratemaking implemented by the Commission “shall” comply with the CPI cap provisions. Restating these requirements in Section 3622(d)(3) would have been repetitive.⁸

⁸ Using the Commission’s own logic, if Congress wanted to grant the Commission authority to ignore the requirements of § 3622(d), it could have expressly stated that the Commission may “adopt such alternative system . . . as necessary to achieve the objectives . . . notwithstanding the requirements of § 3622(d).” These extra words presumably were not omitted just to save on printing costs.

The Commission’s appeal to “Congress’ manifest purposes” is likewise without merit. *Cf.* Order No. 4258 at 18. The purposes of Section 3622(d) are manifest in its text.⁹ Subsection (d)(3) does not say that the Commission may adopt a system that omits or loosens the CPI-based price cap otherwise mandated by Section 3622(d). Subsection (d)(3) does not say that, “notwithstanding the requirements of subsection (d)(1), the Commission may adopt such alternative system . . .” It does not say, “such alternative system need not incorporate the annual limitation on price increases described in subsection (d)(1).” Congress could have easily codified such a “legislative compromise” into the law with this sort of language, but did not do so. Rather, this provision states plainly that “[t]he system for regulating rates and classes for market-dominant products *shall* . . . include an annual limitation” in the form of a CPI-based price cap. 39 U.S.C. § 3622(d)(1)(emphasis added). The unambiguity of this language ends any possible debate about what “Congress’ manifest purposes” might be—assuming that those “manifest purposes” have any relevance here at all.

The plain language of the statute likewise cannot be overcome by its legislative history. First, virtually no legislative history exists. As the Commission acknowledges, none of the legislative history of PAEA speaks to the purpose or proper interpretation of the review provision of Section

⁹ “In analyzing a statute, we begin by examining the text, not by ‘psychoanalyzing those who enacted it.’” *Carter v. United States*, 120 S. Ct. 2159, 2169–70 (2000) (citations omitted). “Policy arguments cannot supersede the clear statutory text.” *Universal Health Services, Inc. v. United States*, 136 S. Ct. 1989, 2002 (2016).

3622(d)(3), which appears to have been added to H.R. 6407 without hearings, Committee consideration, or floor debate. *See* Order No. 4258 at 21. The Commission relates the history of the several predecessor bills, but those sources establish only that the provisions of the earlier bills differed in many respects from the provisions ultimately enacted as PAEA. *Id.* at 19–23.

The Commission and Senators Collins and Carper are surely correct that the final bill was “a difficult compromise.” *Id.* at 23. But, as more recent legislative efforts have confirmed, any postal legislation is likely to require compromise among competing stakeholders and interests. And many aspects of the 2006 law obviously reflect compromise. These include the competing objectives; the limitations on worksharing discounts; the prefunding obligations; the complaint provisions. Bromides about “compromise” reveal nothing, beyond the actual text of the statute as enacted, about the terms of the particular compromises that led to the enactment of PAEA.

Moreover, even if there had been a compromise between a version of the bill that provided for a permanent rate cap and one that offered a rate cap as one option among several for the Commission to choose, the compromise resolving this conflict could well have been to require the Commission to review the operation of the rate system after 10 years and evaluate how to modify it to improve performance while still retaining the CPI-based limitation. Those, in any event, were the terms actually written into the law.

At bottom, the only direct support the Commission offers for its position that Section 3622(d)(3) authorizes it to ignore the statutory requirements of Section 3622(d) and dispense with the CPI-based limitation is a floor statement

by Senator Collins in the Congressional Record. Order No. 4258 at 22 (quoting 152 Cong. Rec. S11674, S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins)). This statement cannot override the plain text of the statute, however.

First, while Senator Collins may have genuinely believed that Section 3622(d)(3) represented a compromise that allowed the Commission to replace the CPI-based price cap after 10 years, a floor statement cannot overcome the plain language of the statute. The courts have become increasingly skeptical in recent years of the probative value of such remarks. The “Supreme Court has repeatedly emphasized that courts should ‘not resort to legislative history to cloud a statutory text that is clear.’” *Nat’l Ass’n of Manufacturers v. Taylor*, 582 F.3d 1, 12 (D.C. Cir. 2009) (citations omitted). In particular, “excerpts from committee hearings and scattered floor statements by individual lawmakers” are “the sort of stuff we have called ‘among the least illuminating forms of legislative history.’” *Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652, 1661 (2017) (per Kagan, J.) (citations omitted). “‘Floor statements’ from members of Congress, even from a bill’s sponsors, ‘cannot amend the clear and unambiguous language of a statute.’” *Nat’l Ass’n of Manufacturers*, 582 F.3d at 12 (quoting *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 456–57 (2002)). “Congress conveys its directions in the Statutes at Large, not in excerpts from the Congressional Record.” *Begier v. I.R.S.*, 496 U.S. 53 (1990) (Scalia, J., concurring)).

Moreover, the Commission’s use of the floor statement proves too much. By the same logic, the reference in subsection (d)(3) to an “alternative system”

would authorize the Commission to disregard in the 10-year review the requirements of Section 3622(e) as well. But the Commission still treats Section 3622(e) as good law. Order No. 4258 at 87–98.

As Carl Sagan once noted, “Extraordinary claims require extraordinary evidence.”¹⁰ It would truly be extraordinary for Congress to have designed a comprehensive set of objectives, requirements, and limitations to govern a system of ratemaking that carefully balanced the competing interests of a regulated monopoly and its ratepayers, only to provide the Commission with the authority to abandon that carefully crafted structure without providing any guidance as to what the Commission should put in its place. Surely, reaching such a conclusion should require more evidence than a single floor statement in the Congressional Record.

E. The Commission’s grounds for distinguishing its prior holdings recognizing the central role and binding effect of the CPI cap are arbitrary and capricious.

The Commission’s current interpretation of Section 3622(d) also cannot be reconciled with the Commission’s prior construction of the same provision. As noted above, the Commission held until recently that the role of the CPI cap in PAEA’s statutory hierarchy is absolute, “central,” “indispensable,” and “it would undermine the basic regulatory approach of the PAEA if the Postal Service could pierce the price cap routinely.” *See* pp. 13-15, *supra* (citing prior Commission holdings).

¹⁰ *See also* DAVID HUME, AN ENQUIRY CONCERNING HUMAN UNDERSTANDING 116 (1912 ed.) (“A wise man . . . proportions his belief to the evidence.”).

The Commission tries to brush off these prior statements on the theory that they involved the role of the CPI in the system of regulation established under Section 3622(a), not the “alternative” system of regulation that the Commission proposes under Section 3622(d)(3). Order No. 4258 at 18. This is a distinction without a difference. The Commission’s prior emphasis on the central role of the CPI cap is important not merely as an exercise in statutory construction but also as an acknowledgement that, as a matter of regulatory fact, the only effective way to protect captive mailers from abuse of the Postal Service’s monopoly power is rigorous enforcement of the CPI cap. *See* pp. 13-15, *supra*. It is in the latter respect that the proposed alternative system most profoundly contradicts the Commission’s previous findings.

For this reason, a final rule adopting the proposed breaches of the CPI cap would likely be overturned on judicial review not only as a violation of Section 3622(d), but also as an unexplained departure from the Commission’s previous findings. *See, e.g., Great Lakes Gas Transmission L.P. v. FERC*, 984 F.2d 426, 433 (D.C. Cir. 1993) (“A full and rational explanation is especially important to this court when the condition imposed reflects a shift in FERC’s policy”); *NLRB v. Curtin Matheson Scientific, Inc.*, 494 U.S. 775, 799 (1990) (determining that where the agency “made no effort to explain the apparent inconsistency between” the decision on review and its prior analyses, “its order is invalid on that basis alone”); *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) (finding that an agency changing its course by rescinding a rule must supply a reasoned analysis for the change); *Erie Boulevard Hydropower, LP v. FERC*, 878 F. 3d 258, 269 (D.C.

Cir. 2017) (“An agency decision that departs from agency precedent without explanation is [] arbitrary and capricious.”).

II. THE PROPOSED REGULATORY SYSTEM VIOLATES THE TERMS OF THE REGULATORY BARGAIN THAT CONGRESS ADOPTED IN SECTION 3622(b).

Because the alternative system of regulation proposed in Order No. 4258 would violate 39 U.S.C. § 3622(d), analysis of the proposal in light of the objectives of Section 3622(b) is unnecessary. But even if Section 3622(d)(3) somehow empowered the Commission to discard the CPI cap, the proposal would need to be rejected for violating Congress’ directive to design a ratemaking system that applies “*each*” one of the nine objectives of Section 3622(b) “*in conjunction with the others.*”

The Commission’s proposals in Order No. 4258 are geared toward a single goal: giving first priority to Objective 5 (assuring “adequate revenues, including retained earnings, to maintain financial stability”). 39 U.S.C. § 3622(b)(5). This approach is inconsistent with the language and structure of the statute, including its directive to apply each of the Objectives in conjunction with the others. Congress would have had no need to list any of the eight other objectives if gaining more revenue were the only goal. *See also* Dissenting Views of Commissioner Hammond at 1 (“[R]ather than balancing all the objectives of 39 U.S.C. 3622, the proposed changes elevate the financial stability objective above the others.”). The Commission’s approach likewise violates a fundamental canon of statutory construction: a statute must be construed as a whole, and not by reading an individual provision in isolation. *K Mart Corp, supra*, 486 U.S. at 291. “It is a great fallacy to think that by

staring hard at an isolated sentence one can come up with a meaningful interpretation.” *Alliance to End Repression v. City of Chicago*, 742 F. 2d 1007, 1013 (7th Cir. 1984) (en banc) (Posner, J.).

Even if (contrary to fact) Objective 5 could properly outweigh all other objectives, the Commission has misapplied that objective on its own terms.

A. The Commission has failed to apply all of the objectives or balance the interests of the Postal Service and its customers.

As the undersigned parties explained in Phase 1, the ratemaking provisions of PAEA required an updated version of the traditional regulatory bargain between a regulated monopoly and its captive ratepayers. *See* ANM *et al.* March 2017 Comments at 13–17. The objectives and factors of PAEA reflect both complementary and competing interests, seeking to allow the Postal Service revenues adequate to provide appropriate levels of service (Objectives 3 and 5), while preventing the Postal Service from abusing its market power at the expense of captive mailers by charging rates that cover inefficient or needlessly high costs (Objective 1 and Factor 12), rise faster than inflation (Objective 2), or exceed “just and reasonable” or “reasonable and equitable” levels (Objective 8, Factor 3, and 39 U.S.C. § 404(b)). The statute further recognizes that revenue adequacy (Objective 5) is a relative term, not a directive to fill the Postal Service’s coffers without regard to cost control, operational and pricing efficiency, or the financial impact of rates on mailers and the public. Finally, the introductory phrase of Section 3622(b) explicitly requires that “each” objective “shall be applied in conjunction with the others,” and the legislative history of Section 3622 confirms that this requirement was

inserted deliberately. *See ANM et al.* March 2017 Comments at 15–16. Because traditional ratemaking principles and the introductory clause of Section 3622(b) require the system of ratemaking to balance all of the objectives listed in that provision, the Commission’s task in Phase 1 of this docket was not to rate the performance of the existing system against each objective in isolation, but to determine whether the system was achieving the objectives as a whole. In other words, the Commission’s task was to determine not just whether the system had achieved particular objectives, but whether it had struck the right balance among them.

The Commission professes to recognize this requirement in Order No. 4257, citing its earlier statement that “the objectives ‘are presented as a group and the application of each is conditioned upon the need to recognize and reflect the others.’” At 17 (quoting Order No. 536 at 36). Indeed, the Commission recognizes the “tension” between the objectives and that “the PAEA is designed to achieve various goals . . . [and] these joint goals will best be achieved if they are balanced with one another.” *Id.* at 17–18 (internal quotations omitted). The Commission further acknowledges its prior findings that its “rules for applying the price cap and the application of those rules help to achieve several objectives of the PAEA. Enforcing the limitation that price increases for each class of mail do not exceed inflation, for example, incentivizes the Postal Service to reduce costs and increase efficiency (Objective 1).” Order No. 4257 at 222 (quoting FY 2015 Annual Report at 22). Order Nos. 4257 and 4258, however, ultimately abandon these principles.

Rather than recognizing that the application of *each* objective must “recognize and reflect” *each other* objective, the Commission has arbitrarily grouped the objectives into three distinct buckets: structure, financial health, and service. *Id.* at 17. The Commission claims that this piecemeal approach “allows application of the objectives together as they relate to specific areas of the system.” *Id.* at 22. But this is not so. The Commission has not *balanced* the objectives *across* these areas (for instance, objectives requiring improved service and objectives seeking revenue adequacy). Nor has the Commission considered whether the structure of the system is working to achieve the objectives *as a whole*. For instance, one of the subtopics the Commission identifies under the “structure” area is “pricing,” a feature that is an integral component of subtopics under the financial stability area (reasonable rates, financial stability, operational efficiency). *Id.* at 22. By analyzing these areas separately, the Commission fails to evaluate in a principled way the effect of each area on other areas.¹¹

¹¹ The empty formalism of this piecemeal approach is illustrated by the Commission’s labored efforts to assign separate meanings to “just” and “reasonable” (*i.e.*, not too high and not too low) and analyze the two terms separately—“just” in the structural area and “reasonable” in the financial health area. Order No. 4257 at 113-1130 (“just”), 226-236 (“reasonable”). The Commission cites no authority for this approach, and none exists. “Just and reasonable” and “reasonable and equitable” (Objective 8 and 39 U.S.C. § 404(b), respectively) are synonyms, and each phrase is a doublet: a pair of nouns that lack separate meaning. See Antonin Scalia and Bryan A. Gardner, *Reading Law: The Interpretation of Legal Texts* 177 (2012). The zone of reasonableness established under these longstanding regulatory terms of art, and the factors that determine the breadth of that zone, are the product of more than a century of legislative, administrative, and judicial precedent. ANM *et al.* March 2017 Comments at 17–18 (citing authorities). As discussed further

The Commission perhaps could have mitigated this flaw by examining whether the current system achieved an appropriate balance *across* the three areas, but it neglected to do this as well. Instead, it simply checked off each objective in isolation, totted up the results—X objectives achieved, Y objectives not—and then proclaimed, without disclosing the Commission’s weighting or interrelationship (if any) of the objectives, that the overall grade was an F.

This approach is both inconsistent with the Commission’s own statements regarding the holistic nature of the statute and arbitrary on its own. Nothing in the statute suggests that the various objectives are susceptible to grouping into sub-areas, each assessed separately from the others; nothing in the statute identifies the three specific areas the Commission chose to group them into; and nothing in the statute endorses the “best two out of three” approach the Commission took to evaluating whether the system has achieved the objectives as a whole.

In the end, without admitting to doing so, the Commission implicitly (but necessarily) has determined that the current system gives too much weight to the factors protecting mailers, and not enough weight to Objective 5. The same implicit priority clearly underlies the rules proposed in Order No. 4258, which elevate the objective of revenue adequacy above all other objectives. The Commission, however, does not explain why the additional revenue it seeks to provide the Postal Service justifies the injury to mailers that will result. It does not explain how transferring \$16 billion of extra

below, the Commission has not even attempted the analysis required by this precedent.

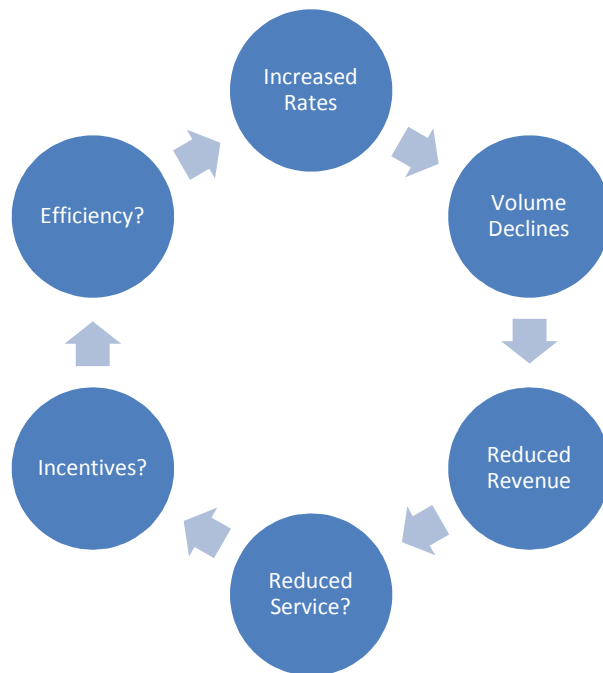
revenue from captive mailers to the Postal Service over the next five years, unconditioned on any improvement in efficiency or reduction in costs, will encourage more efficiency or reduce costs, or why rate increases, not cost reductions, are the only allowed path to financial stability. It does not explain why nominal rate increases as much as 40 percent over five years are a just and reasonable solution when postal labor is being compensated at about double the rates of compensation offered by the private sector for comparable work, and the Postal Service is allowed to continue operating its FSS money pit, maintaining worksharing passthroughs that are certain to cause inefficient mailing practices, and failing to reduce capacity enough. The Commission does not explain why its proposed solutions represent a good balance between protecting captive ratepayers, preventing monopoly abuse (and the disincentives toward cost reduction inherent in monopoly), and providing the Postal Service with the opportunity to earn adequate revenues. The proposed rules simply seek to meet Objective 5, while giving the other objectives lip service only.

B. The proposed alternative system of regulation would violate Objective 1, maximizing incentives for efficiency.

Objective 1 exemplifies why any modified or alternative regulatory system needs to strike an appropriate balance between the objectives of PAEA. If the proper incentives are provided for the Postal Service to reduce costs and maximize efficiency, then its financial stability should improve, its service performance may increase, and the Postal Service can achieve these goals while maintaining just and reasonable rates. Everybody wins.

By contrast, a system designed solely to enhance the Postal Service's financial stability could lead to greater and greater rate increases without increases in service levels or efficiency. In the resulting death spiral, higher rates would depress volume, requiring even higher per-unit rates to recover costs, driving volume down further, until the volume had permanently left the system and the Postal Service had no chance of recovering its operating costs. Everybody would lose. To adapt the figure on page 47 of Order No. 4258:

Figure 2



Further, focusing on the incentives to reduce cost focuses on factors within the Postal Service's control, whereas to some degree, the revenues the Postal Service earns are dependent on broader market factors that affect the demand for mail. Thus, the Commission must keep a close eye on the objective of maximizing incentives to reduce cost and increase efficiency, and this

objective should provide a guiding principle for any redesign of the system for regulating rates.

The Commission found in Order No. 4257 that the current system of ratemaking had not achieved Objective 1, and that “the incentives to reduce costs and increase operational efficiency have not been maximized as intended by the PAEA.” Order No. 4257 at 222. Although ANM *et al.* disagree with the Commission’s approach to analyzing this objective,¹² we agree with the Commission’s conclusion that Objective 1 was not achieved. While there were multiple reasons for this failure, it shows that the existing system of

¹² Among other things, the Commission focuses almost entirely on the results achieved under the current system—*i.e.*, whether and by how much the Postal Service reduced its costs and increased efficiency—and fails to analyze how the *incentives* provided by the *system of ratemaking* affected those results. *See* Order No. 4257 at 222 (finding the Postal Service did experience declines in costs and some improvement to efficiency under PAEA, but concluding solely from that finding that the “incentives . . . have not been maximized . . . because the reductions and improvements were insufficient to address the Postal Service’s financial instability”). Additionally, the Commission’s approach to analyzing Objective 1 concentrates on whether “a system . . . uses available mechanisms, such as flexibility under the price cap, pricing differentials, and workshare discounts, to the fullest extent possible to incentivize the reduction of costs and increases in operational and pricing efficiency.” *Id.* at 182. None of these “incentives” are actually features of the system of ratemaking established by the Commission. Rather, they relate to pricing actions that are entirely within the Postal Service’s purview. The Commission’s approach was structurally incapable of properly evaluating whether the incentives to reduce costs and increase efficiency had been maximized because the inquiry omitted any analysis of how the primary incentive—the price cap—had affected the Postal Service’s efforts to reduce costs and increase efficiency. The Commission also failed to analyze whether other features of its regulatory system, such as its approaches to evaluating workshare discount passthroughs and approving negotiated service agreements, affected the Postal Service’s ability to take advantage of opportunities to increase efficiency.

ratemaking needs to be modified to provide stronger incentives for cost reductions and improvements in efficiency.

Unfortunately, the alternative regulatory system proposed in Order No. 4258 would have the opposite effect. The proposal would allow the Postal Service to raise market-dominant rates by as much as five percent above inflation, equivalent to about \$16 to \$24 billion in extra revenue over five years.¹³ The idea that giving the Postal Service an extra \$16-\$24 billion in revenue over five years will increase its incentive to reduce cost and increase efficiency (as compared to the current system, which the Commission already found does not meet Objective 1) turns incentive ratemaking on its head. Moreover, none of the proposed surcharges, except for a single component of 0.75 percentage points, would require any showing of the Postal Service's efficiency gains or cost reductions.

This is a facial violation of Objective 1. As Commissioner Hammond notes in his dissent, giving the Postal Service additional rate authority based on its inability to recover all of its costs “would grant the Postal Service the benefits of both systems [*i.e.*, cost-of-service and incentive ratemaking] and require of it the sacrifices of neither.” Dissenting Views of Commissioner Hammond at 1.

¹³ Holding market-dominant volume constant, the Commission's proposal will give the Postal Service between \$16 billion in additional revenue over five years (at CPI + 2%) and \$24 billion in additional revenue over five years (at CPI + 3%). Library Reference ANM *et al.*—LR—RM2017-3/4, “Revenue Impacts”, cells E3 & E4.

The Commission offers no cogent response. Instead, the Commission changes the subject, pivoting to the separate issue of whether the Postal Service has the *ability* to improve its efficiency and costs. The Commission asserts that the Postal Service is too starved for “retained earnings” to improve its efficiency or cost control, and that showering more money on the Postal Service would set off a “harmonious cycle” of greater earnings, more capital investments, reduced costs, higher service quality, and increased revenue. Order No. 4258 at 46–53.

This claim is irrelevant to Objective 1 and in any event unsupported by reasoned analysis and refuted by experience. We discuss in turn the incentive effects (*i.e.*, the effects that Objective 1 actually requires the Commission to consider), the income effects hypothesized by the Commission in Order No. 4258, and the historical record of how the Postal Service and other postal operators have actually performed when allowed to raise rates faster than inflation. Finally, we discuss the one element of the proposed system that purports to give the Postal Service stronger incentives for efficiency: the proposed annual surcharge of 0.75 percentage points for maintaining the same rate of productivity growth that the Postal Service achieved during Fiscal Years 2011 to 2016.

1. **Objective 1 requires the Commission to consider the effect of an alternative regulatory system on the Postal Service’s *incentives* to reduce costs and increase efficiency, not the Postal Service’s *financial ability* to make investments.**

The Commission’s proposal to allow the Postal Service to surcharge market-dominant rates by a minimum of two percent above CPI is incompatible with the directive in Objective 1 to “maximize incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). As the Commission has recognized, a price cap based on an exogenous index is the centerpiece of incentive regulation. The prospect of losing money if the costs of the regulated firm rise faster than inflation, or earning extra money if the costs of the firm rise more slowly than inflation, is the primary incentive to reduce costs and increase efficiency under index ratemaking. Order No. 547 in Docket No. R2010-4 (Sept. 30, 2010) at 11–13, *aff’d in relevant part, USPS v. PRC*, 640 F.3d 1263, 1264 (D.C. Cir. 2011); *see generally* ANM *et al.* March 2017 Comments at 19–22 (citing authorities).

Loosening the regulatory price cap necessarily weakens the incentives it provides. There is nothing controversial about this dynamic; it is indeed central to the theory of performance-based regulation. ANM *et al.* March 2017 Comments at 64–66; Nadol Decl. at ¶ 11. In the words of Order No. 547, the price cap “stands as the single most important safeguard for mailers.” At 13. The “role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the incentive to reduce costs is to remain effective. Therefore, *it would undermine the basic regulatory approach of the PAEA if the Postal Service could pierce the price cap routinely.*” *Id.* at 49–50 (emphasis

added). Because even the current system did not meet Objective 1, the weaker incentives offered by the proposed system could not either.

The Commission has acknowledged these principles again in Order No. 4257;¹⁴ the Public Representative's affiants endorse them;¹⁵ the GAO has recognized them;¹⁶ and they can be found in many economics treatises.¹⁷

¹⁴Order No. 4257 at 32 (“A primary motivation for the PAEA’s requirement of the inclusion of the CPI-U price cap in the new system of ratemaking was to provide the incentive for the Postal Service to reduce costs and increase efficiency. The market dominant ratemaking system, including the CPI-U price cap . . . was intended to incentivize the Postal Service to reduce its costs as a way to achieve retained earnings.”) It further explained that “the PAEA places an inflation-based cap on market dominant rate increases while simultaneously setting forth the objective that the Postal Service must maintain financial stability,’ and ‘[t]his puts pressure on the Postal Service to reduce costs and increase efficiency.” *Id.* at 33 (quoting Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2009, January 1, 2010, at 23).

¹⁵ See Declaration of Timothy J. Brennan for the Public Representative (“Brennan Decl.”) at 6 (“[Price cap regulation] improves on traditional regulation by giving the regulated firm an incentive to control costs.”); Declaration of John Kwoka for the Public Representative (“Kwoka Decl.”) at 5 (“[Incentive regulation] seeks to harness the firm’s natural profit-maximizing incentives to adopt best practices and lower its costs.”).

¹⁶ Through PAEA, Congress sought to create a profit motive for the Postal Service and improve efficiencies in the postal networks by eliminating the break-even mandate. See Gov’t Accountability Office, Report No. GAO-07-684T, U.S. Postal Service: Postal Reform Law Provides Opportunities to Address Postal Challenges 1, 17–19 (2007), available at <http://www.gao.gov/assets/120/116185.pdf>.

¹⁷ See, e.g., Crew, Michael A. and Paul R. Kleindorfer, “A critique of the theory of incentive regulation: implications for the design of performance based regulation for postal service,” in FUTURE DIRECTIONS IN POSTAL REFORM (Crew and Kleindorfer, eds.) (2001).

Perhaps the only party to dispute these principles in Phase 1 was the Postal Service itself.¹⁸

2. The Commission’s “harmonious cycle” hypothesis is unsupported speculation.

Order No. 4258 makes no findings, and cites no evidence, that the incentive effect of index regulation is weaker today than in 2006 or 2010. Nor has the Commission attempted to reconcile its findings about the incentive effect of the CPI cap in Order No. 4257 with the Commission’s proposals in Order No. 4258 to breach the cap. Instead, the Commission contends in Order No. 4258 that giving the Postal Service more money will increase the Postal Service’s *ability* to invest in efficiency and productivity growth, a budget effect that the Commission touts as a “harmonious cycle.” But the *ability* to invest in productivity and cost savings is distinct from the *incentive* to do so, and the latter may be undermined by over promoting the former. Section 3622(b) requires the Commission to consider *both*—the incentive through Objective 1,

¹⁸ As the Commission relates, the Postal Service self-servingly claims that it does not need incentives in the system of ratemaking “to aggressively focus on increasing operational efficiency and reducing costs” and that the incentives provided by the price cap did not drive the efficiency gains it did make. Order No. 4258 at 59. The Postal Service’s position that competitive pressures would drive it to find new efficiencies, if only it had the money to do so, is absurd. If the Postal Service were truly operating in a competitive environment, it would not be able to sustain above-CPI rate increases for long enough to gain the benefit of these revenue increases. It would be forced to drop its prices or go out of business. The Postal Service seems to have changed its position from when the current system of regulations was developed. See Docket No. RM2007-1, Initial Comments of the USPS (Apr. 6, 2007) at 22 (“A price cap system . . . provides greater incentives for efficiency due to the fact that it fundamentally changes the relationship between cost and price.”).

the ability through Objective 5. By focusing on the ability to the exclusion of the incentive, the Commission has violated both Section 3622(b)(1) and the Commission's duty to provide reasoned justification for abandoning its previous findings.

The Commission's "harmonious cycle" hypothesis would be arbitrary even if (contrary to fact) Objective 1 focused on the Postal Service's ability, not its incentive, to reduce costs and increase efficiency. The notion that insufficient investment capital is the sole (or even primary) reason that the Postal Service does not operate more efficiently and at lower cost rests on unsupported speculation and a misunderstanding of how business enterprises finance investments.

The Postal Service has funds to make additional investments. It holds about \$10 billion of cash, and has been generating about \$3 billion in additional cash from operations each year. USPS Form 10-K for Fiscal Year 2017, at 48; *cf.* ANM *et al.* March 2017 Comments at 34–35.

The "analysis" offered by the Commission to support the "harmonious cycle" hypothesis consists of six pages of tables of post-2006 financial data purporting to show that the Postal Service is short of money, Order No. 4258 at 48–53, and a figure with circles and arrows depicting, at a purely illustrative level, how the Commission thinks that more money could lead to more spending on improved efficiency, *id.* at 47 (Figure III-2). This simplistic "analysis" proves nothing about how more revenue would affect the Postal Service's costs or efficiency.

The Commission is simply incorrect in assuming that retained earnings are necessary to fund capital investments. The accrued costs of capital investments are included in the Postal Service's reported expenses as non-cash depreciation expenses. Thus, if the Postal Service earns sufficient revenue in a year to cover its accrued operating costs, it will have earned enough revenue to fund capital investments. In other words, the Postal Service can fund capital investments so long as it is meeting the Commission's definition of *short term* financial stability.

While retained earnings certainly *could* be used to fund investment, this is not why Congress replaced the breakeven requirement of the Postal Reorganization Act with the right to retain earnings under PAEA. Rather, PAEA holds out the possibility of retaining earnings as an incentive for the Postal Service to reduce costs and improve efficiency, in line with the theory of incentive regulation. The purpose of allowing the firm to retain earnings is to delink prices from costs, thus incenting the firm to reduce costs so that it can realize the differential between the cost of providing service and the revenues collected for that service. Likewise, as John Kwoka explained last year on behalf of the Public Representative, retained earnings could be used to develop "a compensation system for senior managers . . . that provides rewards for achieving certain efficiency goals, thus replicating the incentives of a residual claimant." Kwoka Decl. at 14.¹⁹

¹⁹ The development of such a system could mitigate the fact that the Postal Service, because it lacks shareholders (the traditional claimants to retained earnings), might be less inclined to respond to the incentives provided by an ability to retain earnings. See Kwoka Decl. at 14; Brennan Decl. at 8.

The Commission’s statement that “[r]etained earnings can be used to pay down debt and borrowing can be used to finance capital investments,” Order No. 4258 at 47, is likewise wide of the mark. While retained earnings *could be* used to pay down debt, this is a choice left to the management of the firm. The cost of debt service is a normal cost of business; if the firm has extra funds to pay down debt on an accelerated schedule, it may choose to do that instead of, for instance, providing employees with bonuses. And if the firm’s goal is to pay down debt, then it has an incentive to reduce other costs to generate the retained earnings to do so.

The Postal Service’s historical experience confirms that investments do not require retained earnings. The Postal Service managed to make capital investments in efficiency and cost reduction during 1971-2007, when the breakeven requirement of the Postal Reorganization Act forbade the Postal Service from retaining earnings as a matter of law.²⁰ The Postal Service has continued to make capital investments in the post-PAEA era. The most recent USPS Form 10-K shows that the Postal Service records its “Depreciation and amortization” as \$1.677 billion in FY 2017, \$1.740 billion in FY 2016, and \$1.769 billion in FY 2015. Those amounts average \$1.729 billion over the last 3 years.

²⁰ As the initial rates under PAEA were simply the rates carried over from the PRA era, these rates should be presumed to have been designed to cover the costs of capital investments. Moreover, PAEA permitted the Postal Service to file one final rate case before the price cap would take effect. Since the Postal Service declined this opportunity, one could reasonably conclude that it believed its revenues would continue to be sufficient to fund capital expenditures.

The Commission, while not disputing that the Postal Service has made (and continues to make) significant capital investments, claims that their amount is too low to meet the Postal Service's current and future needs. But the extent, if any, of a capital shortfall is a factual question. A serious analysis of this question would require the Commission to do (among other things) the following:

- (1) Identify the investments that the Postal Service has failed to make for want of sufficient retained earnings.
- (2) Identify the additional investments that the Postal Service would make if the rate surcharges proposed in Order No. 4258 were implemented.
- (3) Quantify the likely return on those investments, including the net present value of the project, which depends on (among other factors) the capital required, the capital costs, the operating and capital costs avoided, and the increased revenue generated.
- (4) Quantify the offsetting slackening of efficiency and cost control resulting from the gain in income.

See, e.g., Stewart C. Myers and Richard A. Brealey, *Principles of Corporate Finance* 105–11, 119–40 (2003); Richard A. Brealey and Stewart C. Myers, *Capital Investment and Valuation* 103–28, 221–305 (2003).

Merely to list the necessary analyses is to make clear that the Commission has not performed them. The Commission has not identified *any* specific capital investments that the Postal Service has foregone other than the

immediate upgrading of its transportation fleet.²¹ Still less has the Commission quantified the investments (if any) that would have reduced the Postal Service's costs and increased its efficiency, the likely returns on those investments, the projected efficiency gains, the projected gain in revenue, or the magnitude of the offsetting reduction of incentives for efficiency and cost control. Indeed, the Commission *cannot* perform these analyses, for it has refused to allow discovery from the Postal Service of the information needed to conduct investment analyses of this kind. *See* Order Nos. 3763, 3807, and 4397.²²

This failure of proof cannot be remedied by assuming, as the Commission apparently does, that the appropriate level of investment is or will be the same as during the era of the Postal Reorganization Act. There is no evidence in the record suggesting that the PRA-era level of investment was appropriate, or that the same level of investment is necessary in the current environment. To the contrary, one of the main defects of cost of service ratemaking, such as existed under PRA, is its tendency to encourage

²¹ There is plenty of cash for this purpose, and the payback period should be quick, particularly given the large maintenance costs of the Postal Service's aging vehicle fleet. *See* OIG Report No. DR-MA-14-005, *Delivery Vehicle Fleet Replacement* 6-7 (June 10, 2014).

²² The Commission's insistence that mailers enjoy "robust" opportunities for comment without this information, Order No. 4397 at 5, is disingenuous. Information about the anticipated cost of and returns on potential Postal Service investment projects is generally in the exclusive possession of the Postal Service. The Postal Service effectively admits this when it contends, undoubtedly correctly, that the information is "commercially sensitive." *Id.* at 4. "Commercially sensitive" information is by definition unavailable to the public. *See* 39 C.F.R. § 3007.1(b).

overinvestment. The more the firm expends, the more it can raise its rates.²³ One of the central advantages of performance-based ratemaking is that it eliminates this perverse incentive. Thus, one would expect capital expenditures to decline under the PAEA's price cap regime when compared to the cost of service system embodied in PRA. The price cap was intended in part to force the Postal Service to more carefully consider its capital expenditures and eliminate wasteful projects. The Commission does not consider whether the reduction in capital expenditures during the PAEA era represents a prudent frugality or a forced deprivation. Order No. 4258 simply assumes the latter from the very fact that expenditures declined.

Finally, the Postal Service has squandered its borrowing authority. Rather than use it to fund investments in efficiency, the Postal Service borrowed funds during the recession to make prefunding payments. *See, e.g.*, USPS OIG Report No. FT-WP-15-003, *Considerations in Structuring Estimated Liabilities* at 3 (Jan. 23, 2015) ("The \$15 billion debt to the Treasury is a direct result of the prefunding mandate"); Kwoka Decl. at 20. This diversion of the Postal Service's limited borrowing authority was questionable at best, since it was foreseeable that the Postal Service could stop making the prefunding payments without a penalty—as has in fact occurred.

²³ Averch, Harvey, and Leland Johnson, "Behavior of the Firm Under Regulatory Constraint," 52 *American Econ. Rev.* 1053–69 (1962); Baumol, William J., and A. Klevorick, "Input Choices and Rate-of-Return Regulation: An Overview of the Discussion," 1 *Bell J. of Economics and Management Science* 162–190 (1970); Bailey, Elizabeth, *Economic Theory of Regulatory Constraint* (1973).

Ultimately, the Commission’s “harmonious cycle” theory is contrary to fundamental principles of economic theory underlying the regulation of monopoly enterprises. Indeed, regulators have shifted to incentive regulation rather than cost of service regulation precisely because this “harmonious cycle” does not exist. Rather, when a regulated monopoly firm is guaranteed recovery of all of its capital investments, it tends to overinvest in facilities and ignore opportunities to reduce costs and increase efficiency. *See* pp. 46-47 & n. 23, *supra*.

3. The historical data confirm that the proposed alternative system would lead to ballooning costs and diminished efficiency.

A wealth of empirical data confirms the adverse incentive effects of breaching the CPI cap.

(1) Declines in Postal Service productivity growth historically have corresponded with periods during which the Postal Service had access to revenue above the CPI cap. When above-CPI rate increases have been allowed, productivity growth has declined and costs have increased. This relationship is confirmed by the events that followed the implementation in Fiscal Year 2014 of the exigent surcharge approved in Docket No. R2013-10. Between Fiscal Years 2010 and 2013, the Postal Service achieved productivity gains of 1.56 percent per year.²⁴ But productivity growth collapsed in 2014, after the exigent surcharge was approved and implemented, and became negative in

²⁴ *See, e.g.*, ACR 2015, USPS Response to Chairman Information Request No. 7, Question 16.

2016 and 2017,²⁵ when the Commission began its public campaign to allow above-CPI rate increases in the 10-year review:²⁶

Table 1. TFP Average Annual Growth Rate (Selected Periods)

Period	Annual Productivity Change
Pre-PAEA (FY 1997 – FY 2006)	1.03%
PAEA – Before Exigency (FY 2007 – FY 2013)	0.91%
Before Exigency (FY 2010 – FY 2013)	1.56%
Since Exigency (FY 2014 – FY 2017)	– 0.08%

Source: Library Ref. ANM *et al.*-LR-RM2017-3/4, “Table 1 & Figure 3”.

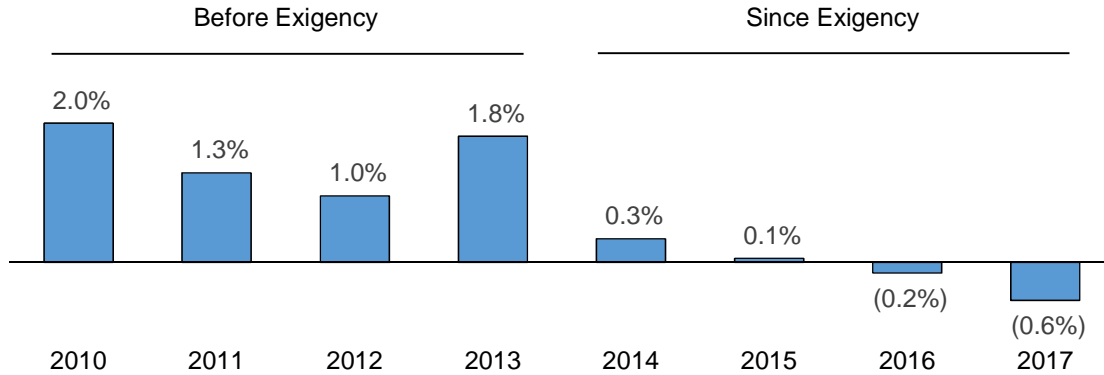
If the Postal Service had achieved annual productivity gains of even *one percent* over the last four years, it would have made a profit in FY 2017.²⁷

²⁵ Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 1 & Figure 2”, cells D23:D26.

²⁶ See, e.g., *Nominations of Hon. Robert G. Taub and Hon. Mark D. Acton*, Hearings before the Senate Comm. on Homeland Security and Government Affairs, 114th Cong., 1st Sess. (Nov. 15, 2016) at 19 (statement of Chairman Taub) (“First, and foremost, the financials need to be fixed.”)

²⁷ Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 1 & Figure 2”, cell D15 calculates how much lower the costs would have been in FY 2017 with a 1% growth in Total Factor Productivity. The calculation shows that costs would have been almost \$3 billion less.

Figure 3. TFP Annual Growth Rate for FY 2010 – FY 2017



Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 1 & Figure 3”.

(2) A similar dynamic has played out in European countries that have relaxed their limitations on maximum prices for postal products in recent years. The postal operators’ finances have improved through large rate hikes (at least temporarily), but productivity and cost control have languished. If Section 3622(b) had applied to European postal operators, their performance would have violated Objectives 1, 2 and 8.

In late 2016, WIK-Consult studied the performance of six major foreign postal operators for the OIG. USPS OIG Report No. RARC-17-003, *Lessons in Price Regulation from International Posts* (Feb. 8, 2017). In Australia, where market-dominant postal services are subject to cost-of-service rate regulation (not index regulation), service quality has declined, and regulated prices experienced increases in the range of 40 percent to 114 percent in January 2016. *Id.* at 22, 26. In Canada, which replaced price cap regulation in 2009 with price regulation “based on political decisions rather than a fixed economic methodology,” letter mail prices rose by approximately 35 to 59 percent in 2014. *Id.* at 28. In France, where the postal regulator allows a negative

productivity adjustment for falling mail volume, price increases have exceeded inflation several times. *Id.* at 36–40. In the United Kingdom, which has eliminated or loosened maximum rate regulation for most mail products, the price of a 100 gram first-class letter increased by 88.2 percent between 2007 and 2016; the price of a 100 gram second-class letter more than doubled. *Id.* at 55–57.

Another study by WIK-Consult detailed the breakdown of Royal Mail’s cost discipline that has followed the loosening of maximum rate regulation. The conclusions of the WIK report are chilling. “Targeted cost savings in delivery are relatively low.” WIK-Consult report to OFCOM, *Review of the Projected Costs within Royal Mail’s Business Plan* (Mar. 31, 2016) at 109. “The company relies on traditional ways of organising delivery and does not (yet) appear to be pursuing more innovative delivery models.” *Id.* “We consider Royal Mail’s parcel automation programme is less ambitious than its peers.” *Id.* “[I]nternational peers in Denmark, Sweden, the Netherlands and Germany appear to have been more successful at managing the relationships with their employees and unions and, at the same time, agreeing [sic] higher levels of efficiency and cost flexibility, allowing them to meet market challenges more effectively.” *Id.* at 110. “Overall, we conclude that Royal Mail’s planned initiatives are technically feasible but, overall, less ambitious than its peers.” *Id.* at 111.

The problems stemming from lax maximum rate regulation in these other countries have continued during the past 12 months. Just this month, Royal Mail announced above-inflation price hikes on first and second class

stamps, which “will be of most concern to regular postal users and small businesses that rely on Royal Mail to send important documents and packages.”²⁸ Australia Post, for its part, continues to experience service quality problems even as it has imposed a number of price hikes in recent years, with “small business noticing an increase in missing letters across the last 12 months.”²⁹

The historical record thus shows that providing the Postal Service with above-CPI rate increases would not result in faster productivity growth or lower costs. This outcome is unsurprising; in fact, it is predicted by established principles of incentive regulation.

ANM *et al.* noted these facts on pages 51-54 and 64-66 of their March 2017 comments. Order Nos. 4257 and 4258 ignore the point completely.

4. The 0.75 percent surcharge proposed for maintaining recent rates of productivity growth does not cure the violation of Objective 1.

The reduction in incentives created by loosening the price cap cannot be remedied by the one element of the proposal the Commission identifies as an incentive proposal—*i.e.*, the proposal to allow the Postal Service to surcharge rates by another 0.75 percent above CPI if it meets specified productivity goals. *See* Order No. 4258 at 56. Not only would this additional surcharge authority

²⁸ Edmund Greaves, “Royal Mail Announces Inflation-Busting Stamp Price Hikes,” *Moneywise* (Feb. 19, 2018), available at <https://www.moneywise.co.uk/news/2018-02-19/royal-mail-announces-inflation-busting-stamp-price-hikes>.

²⁹ Daniel McGookin, “A Stamp of Disapproval,” *Macarthur Chronicle (Australia)* (Dec. 5, 2017).

fail to outweigh the reduction in incentives resulting from the other proposed surcharges, none of which would be conditioned on achieving any productivity gains at all, but the 0.75 percent “productivity” surcharge would be available merely for *maintaining* recent meager productivity trends, and thus would provide no incentive for the Postal Service to improve them.

First, the notion of providing a regulated utility with *additional* pricing authority to reward improvements in productivity has it backwards. Contrary to the Commission’s statement that a “Performance Incentive Mechanism” may “take[] the form of . . . a bonus (*e.g.*, additional rate authority) . . . tied to performance criteria,” we are aware of no other price cap based regulatory regime that incorporates such a matching grant provision. Order No. 4258 at 55. To the contrary, the usual question facing regulators is the opposite: by how much should the index-based rate increase authority be *reduced* to force the regulated monopoly to *share* some of its realized productivity gains with its captive customers.

In a pure price cap system, the regulated firm is entitled to receive all of its gains in productivity against the index. That is, if the cap allows price increases of two percent in line with the expected industry-wide increase of costs, but the regulated firm is able to limit its cost increases to one percent by improving productivity, it can retain the benefit of its productivity—it gets the revenue from the full two percent price increase even though its costs only rose by one percent. Many regulatory regimes, however, include an “X” factor designed to force the regulated firm to share some of its productivity gains with

its customers.³⁰ In the above example, an X factor of 0.5 percent would restrict the firm's price increases to 1.5 percent, rather than 2 percent. The firm would keep the benefit of its productivity increases between the one percent of cost increases and 1.5 percent of price increase; its customers would receive the benefit between the 1.5 percent price increase and two percent industry-wide cost increases.

The Commission's proposal, by contrast, would flip the CPI-X adjustment upside down. The Postal Service would keep not only the entire gain in contribution resulting from holding its cost reductions below the growth in the CPI, but captive mailers would be required to pay the Postal Service a matching grant of 0.75 percent. Perversely, the mailers would be worse off than if the Postal Service had achieved no productivity gains at all.

Second, even setting aside these concerns about regulatory design and equity, the Commission's proposal fails to "maximize incentives" to increase productivity because it provides no incentive for the Postal Service to increase productivity any faster than under the current system of ratemaking. The Commission proposes to condition the availability of this additional pricing authority on the Postal Service's continuation of its average rate of

³⁰ See ANM *et al.* March 2017 Comments at 70 (citing *Edison Electric Institute v. ICC*, 969 F.2d 1221 (D.C. Cir. 1992); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 183–84 (D.C. Cir. 1993); *Bell Atl. Telephone Cos. v. FCC*, 79 F.3d 1195 (D.C. Cir. 1996); *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1435, 1437 (D.C. Cir. 1996)); Viscusi, W. Kip *et al.*, *Economics of Regulation and Antitrust* 440 (4th ed. 2005). See also Brennan Decl. at 6 ("Because the primary rationale for [price cap regulation] is to give the firm an incentive for cost savings, the X term reflects a politically determined division of those expected gains between the firm and its ratepayers.").

productivity growth between FY 2011 and FY 2016: the Commission “anticipates that the Postal Service’s operational efficiency for the next 5 years will continue to increase at least at the same rate that it has over the most recent 5 years of the PAEA era.” Order No. 4258 at 62. But this rate of productivity growth, by the Commission’s own admission, was deficient.

The Commission acknowledges that the Postal Service³¹ was “unable to achieve increases in efficiency” during the post-PAEA era “at a greater rate than . . . the 10 years prior to implementation of the PAEA.” Order No. 4258 at 58 (citing Order No. 4257 at 22–26).³² Moreover, Order No. 4257’s conclusion that the current system is not maximizing incentives for efficiency depends in part on the finding that the current rate of productivity growth is insufficient to place the Postal Service on a path to financial stability.³³ Yet

³¹ The Commission actually states that “the system” was unable to achieve these gains. Order No. 4258 at 58. Its phrasing is consistent with the generally conclusory nature of Order No. 4257 in which every aspect of the Postal Service’s financial condition is automatically attributed to the current system of rate regulation rather than potential alternative causes. As discussed throughout these comments, no system of rate regulation can force the Postal Service to make productivity improvements, reduce costs, or improve efficiency. The system can only provide the incentives and opportunities to do so; the Postal Service must take advantage of these. The Commission’s primary, fundamental error in Order No. 4257 was ascribing the Postal Service’s shortcomings to the current system of ratemaking, in particular the CPI-based price cap, without demonstrating a causal link.

³² *But see* Order No. 4257 at 191 (“[B]ecause the Commission uses real unit market dominant attributable cost as the determinative metric, the Commission determines that costs were reduced during the PAEA era.”), 211 (“Therefore, using TFP as the determinative metric, the Commission determines that efficiency increased during the PAEA era.”).

³³ *See* Order No. 4257 at 221 (evaluating whether “gains realized through cost reductions and efficiency increases were sufficient to contribute to the overall

the Commission concludes that providing the Postal Service with additional rate authority simply for maintaining this meager rate of productivity growth “should incentivize the Postal Service to achieve efficiency gains sufficient to contribute to the financial stability of the Postal Service.” Order No. 4258 at 62. This conclusion is nonsensical. The obvious purpose (and main effect) of this proposed productivity “incentive” is to give the Postal Service more revenue, not to encourage greater efficiency and cost reduction.

Third, the Commission offers no data or analysis to show that a surcharge of 0.75 percent is either necessary or sufficient to incent optimal rates of productivity growth. The value appears to have been “plucked out of thin air.” *Sinclair Broadcast Group, Inc. v. FCC*, 284 F.3d 148, 162 (D.C. Cir. 2002). Without reasoned support for the 0.75 percent figure, the surcharge lacks the “reasoned explanation” required by the courts. *Id.* (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)); *San Antonio, Texas v. United States*, 631 F.2d 831, 852 (D.C. Cir. 1980).

There are no other incentives to reduce costs and increase efficiency in the Commission’s proposed rules.³⁴ One therefore cannot conclude that the proposed system would maximize these incentives to a greater degree than the

financial stability of the Postal Service”), 222 (“As shown in the preceding sections, the Postal Service was able to reduce costs and increase operational efficiency during the PAEA era. However, the results were insufficient to achieve overall financial stability for the Postal Service.”).

³⁴ While the proposed changes to workshare rules would give mailers improved pricing signals to determine whether to perform worksharing, the changes would not affect the Postal Service’s cost and efficiency in performing the remaining postal functions.

existing incentive. The 0.75 percent “performance” authority would reward the Postal Service for merely maintaining the status quo, and the other surcharges proposed in Order No. 4258 would weaken the incentives now provided by the CPI cap. If the existing system has not achieved Objective 1, still less would the proposed system.

* * *

In sum, the Commission’s hypothesis that showering the Postal Service with \$16 to \$24 billion in extra revenue over five years would “maximize incentives to reduce costs and increase efficiency” is unsupported by meaningful analysis and contrary to regulatory economic theory, the policy of PAEA, previous Commission findings, and historical experience. The proposal is utterly incompatible with Objective 1.

C. The proposed system of regulation would violate Objective 2, rate stability.

The Commission’s proposals would violate Objective 2, “to create predictability and stability in rates.” 39 U.S.C. § 3622(b)(2). As noted above, the system proposed in Order No. 4258 would allow rates on market-dominant products to increase by 40 percent or more over five years.

Order No. 4258 contains almost no discussion of how the Commission’s proposal would lead to stability in rates. Instead, the Commission tries to redefine Objective 2 by suggesting that rates are stable as long as the timing and magnitude of any rate increases are *predictable*. See, e.g., Order No. 4258 at 38 (“Providing a discrete amount of supplemental rate authority on a steady and regular annual basis for 5 years should put the Postal Service on the path

to medium-term financial stability while also taking into account pricing predictability and stability”); *id.* at 77 (“Given the substantial increase needed for some non-compensatory products to cover their attributable costs, a 2-percentage point rate increase represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2.”). The Commission’s redefinition of the statutory term “stability in rates” is untenable.

Objective 2 requires that the system of ratemaking do more than make rate increases be predictable. The objective protects mailers by limiting the *amount* of the increases as well. Rates are stable within the meaning of Objective 2 if they hold constant after adjusting for inflation. *Rates that increase measurably faster than inflation violate the stability objective.*³⁵

The Commission has held repeatedly that “rate stability” means that average prices for a class do not increase materially faster than the CPI. Order No. 547 at 38 (“Section 3622(d)(1) of title 39 provides *rate stability* and predictability *through a cap on annual rate increases for each market dominant mail class at the level of CPI-U*”) (emphasis added). Indeed, the Commission again acknowledged the correct meaning of the term in Order No. 4258 itself,

³⁵ Moreover, the rate increases that Order No. 4258 proposes to authorize would not achieve rate predictability either. Some of the proposed rate increases would be based on changes in Total Factor Productivity, which cannot be predicted in advance. The separate surcharge mechanism proposed for noncompensatory products and classes would generate additional unpredictability because the relevant cost coverage of a product or class will not be known until the “most recent Annual Compliance Determination” is filed. Proposed 39 C.F.R. § 3010.202(a).

and in another order issued only three weeks ago. In Order No. 4258, the Commission asserted that PAEA was intended to allow mailers “10 years of rate stability” before the Commission could change the rules to allow above-CPI rate increases. At 17. By necessary implication, the advent of above-CPI rate increases would mark the end of rate stability.

Order No. 4400 in Docket No. RM2017-12, *Periodic Reporting (Proposal Eight)* (Feb. 7, 2018), is even more to the point. The Commission held that a proposed one-time rule change that would have subjected Nonprofit Regular and Nonprofit ECR mail to rate increases of only 4.2 percent and 0.74 percent, respectively, “would contravene the objective of predictability and stability in rates pursuant to 39 U.S.C. § 3622(b)(2)”. Order No. 4400 at 16. Order No. 4400 is particularly telling, since the rate increases proposed in that docket were not only smaller than the percentage increases that Order No. 4258 would allow, but would have been nonrecurring.

The Commission’s longstanding interpretation of Objective 2 is supported by its structure. Objective 2 is stated in the conjunctive: to create “predictability *and* stability in rates” (emphasis added). Predictability and stability have distinct meanings: the first word denotes the foreseeability of a value or condition; the second denotes its immutability.³⁶ Construing Objective 2 as being satisfied by rate increases that exceed the CPI, albeit in a predictable amount and frequency, would conflate the two concepts, violating

³⁶ See, e.g., Webster’s New Collegiate Dictionary (1981) at 899, 1122; 12 Oxford English Dictionary 334 (2d ed. 1989) (predictability); 16 *op. cit.* at 429–30 (stability).

the anti-surplusage canon of construction, which presumes that every word in a phrase be given effect if possible. *Amoco Prod. Co. v. Watson*, 410 F.3d 722, 733 (D.C. Cir. 2005) (“It is a familiar canon of statutory construction that, ‘if possible,’ we are to construe a statute so as to give effect to ‘every clause and word.’”) (quoting *United States v. Menasche*, 348 U.S. 528, 538–39 (1955)).³⁷

The Commission’s longstanding interpretation of the statutory term “stability in rates” is also consistent with the standard usage of the term “price stability” among economists. Economists in both the United States and in Europe define long-term price stability as a rate of inflation under two percent—not a rate of inflation that is higher by a predictable amount. See Federal Open Market Committee, *Statement on Longer-Run Goals and Monetary Policy Strategy* (as amended Jan. 30, 2018) available at https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf (downloaded Feb. 27, 2018); Ben S. Bernanke, *Opening Remarks at the Ceremony Commemorating the Centennial of the Federal Reserve Act*, (Dec. 16, 2013) (explaining that Federal Reserve set two percent as inflation goal to meet Congressional mandate for price stability); Steven R. Blau, *The Federal Reserve and European Central Bank as Lenders-of-Last-Resort: Different Needles in Their Compasses*, 21 N.Y. Int’l L. Rev. 39 (2008) (noting the European Central Bank “has a quantitative definition of ‘price stability’ of ‘close to, but below’ 2 percent.”).

³⁷ Because “predictability” and “stability” have distinct meanings, the phrase “predictability and stability in rates” does not fall within the exception to the anti-surplusage canon for doublets. Cf. p. 32 n. 11, *supra*.

The Commission’s longstanding interpretation of the statutory term “stability in rates” is further supported by the legislative history of PAEA. In virtually every discussion of the principle of predictable and stable rates, the overriding concern is affordability. The committee report on the Senate bill made clear that the drafters regarded rate “stability” in terms of the rate of inflation, and as a concept distinct from “predictability”:

In hearings, witnesses from the mailing industry cited the need for predictable and stable rates. . . . Of primary importance, then, is the establishment of a regulatory system that will provide for limits on the percentage change in Postal Service rates. This system—frequently referred to as a rate or price cap—*shall be designed to limit annual rate changes based on the level of inflation.*

S. Rep. No. 318, 108th Cong., 2d Sess. 10 (July 22, 2004) (emphasis added).³⁸

³⁸ The sponsors’ floor statements, while of admittedly limited probative value, are in the same vein. Senator Carper tied the concept of rate stability directly to the CPI-based limitation: “the price of those products *cannot go up in a given year by more than the rate of inflation* That will provide a measure of ***stability*** to the huge industry that relies on the post office and a good postal service.” Statement of Mr. Carper, 152 Cong. Rec. S00000-15, (Dec. 8, 2006) (emphasis added). Rep. Miller also endorsed this definition, explaining that “this bill will . . . implement a logical, reasoned process for increases in postal rates, which will generally be *in line with the rate of inflation*. Such stability and predictability will allow the Postal Service to grow along with the needs of its customers.” Statement of Mrs. Miller, 152 Cong. Rec. H9160-02, (Dec. 8, 2006) (emphasis added). And Rep. Shays stated, “By limiting the amount of future postage rate increases . . . the bill also takes an important step towards encouraging the Postal Service to increase mail volume and keep the mailbags full while giving mailers predictability and stability.” Statement of Mr. Shays, 152 Cong. Rec. H9160-02, (Dec. 8, 2006). These legislators all explicitly linked the concept of rate “stability” to price increases in line with inflation.

The above-CPI rate increases contemplated in Order No. 4258 would not come close to meeting the economists' definition of price stability, let alone the more restrictive definition of rate stability incorporated in Objective 2. When inflation is in the range of two percent, annual rate increases in the range of six to seven percent for noncompensatory products and four to five percent for other market-dominant products are inconsistent with rate stability under Objective 2 no matter how predictable the magnitude and timing of the increases.

D. The proposed alternative system of regulation would violate Objective 8 (39 U.S.C. § 3622(b)(8)) and 39 U.S.C. § 404(b), which require that postal rates be just and reasonable.

The alternative system proposed in Order No. 4258 would likewise violate Objective 8 (which calls for the ratemaking system to “establish and maintain a just and reasonable schedule of rates”) and 39 U.S.C. § 404(b) (which authorizes the Governors to establish “reasonable and equitable rates of postage and fees,” which are limited, *inter alia*, to levels “sufficient” to cover the costs of providing an appropriate level of postal services “under best practices of honest, efficient, and equitable management”).

As the undersigned parties explained on pp. 17-18 of their Phase 1 comments, the phrase “just and reasonable” and its synonym “reasonable and equitable” are terms of art that in and of themselves incorporate the regulatory bargain. The standard requires, among other things, that captive ratepayers be protected from having to pay for needlessly high costs or needlessly low efficiency. *See, e.g., Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168,

1177 (D.C. Cir. 1987) (stating that zone of reasonableness is “bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates”) (quoting *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 15 (D.C. Cir. 1950)); *Farmers Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (referring to “decades” of precedent holding that rates must fall within a “zone of reasonableness” where rates are neither “less than compensatory” nor “excessive,” thus “striking a fair balance between the financial interests of the regulated company and the relevant public interests”) (internal quotations omitted); *City of Chicago v. FPC*, 458 F.2d 731, 750–51 (D.C. Cir. 1971) (describing the necessary balance between a rate high enough to attract capital and low enough to prevent exploitation of consumers), *cert. denied*, 405 U.S. 1074 (1972). Congress is presumed to have understood Objective 8 and Section 404(b) in this sense when enacting them. *C.I.R. v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 159 (1993).

Orders No. 4257 and 4258 do not begin to justify the proposed alternative system in terms of these requirements. The discussion of the “just and reasonable” rate standard in Order No. 4257 is lengthy but uninformative. The Commission states that a rate is “unjust” if it is “excessive to mailers,” Order No. 4257 at 116, but provides no objective benchmarks for determining when a rate is “excessive.” Answering that question, the Commission states, requires a “highly fact and situation specific inquiry intended to be undertaken on a case-by-case basis.” *Id.* at 121.

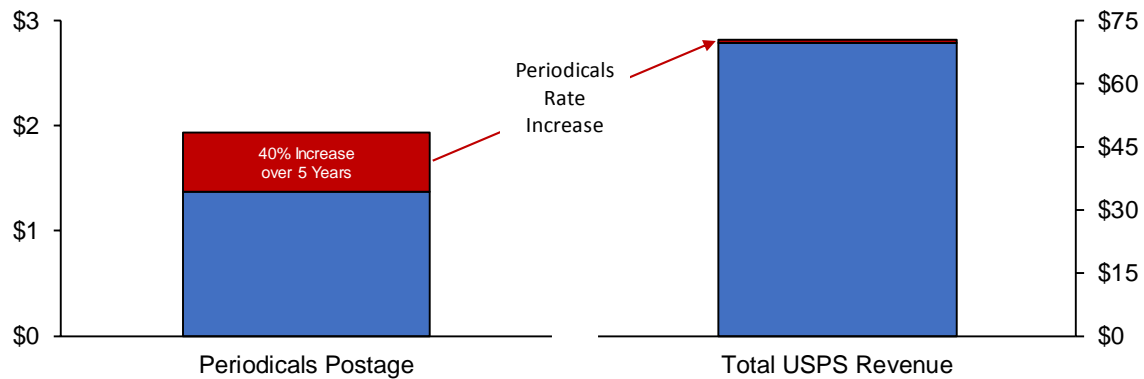
Order No. 4258 ignores the question entirely. The order, while briefly alluding to Objective 8 in the context of *minimum* rates, Order No. 4258 at 77

and 85, says nothing about the separate question of whether the rate increases permitted by the alternative system would fall within the *maximum* of the zone of reasonableness under Objective 8 or Section 404(d). The obvious issue raised by the proposed alternative system—whether it would be just and reasonable to raise prices on market-dominant products well above inflation even if the Postal Service does nothing to reduce its massively inflated costs or take advantage of the alternative sources of revenue and cost savings available to the Postal Service now and in the foreseeable future—is not mentioned at all.

The proposed rate increases thus would violate Objective 8 and 39 U.S.C. § 404(b) even if captive mailers could pay the proposed rate increases without serious injury. In fact, the proposed increases would likely devastate mailers. The destruction of “noncompensatory” mail would be especially severe, and the financial gains to the Postal Service would be surprisingly modest even in the unlikely event that the price increases caused no falloff in volume.

Periodicals Mail is a prime example. Holding mail volume constant, the proposed increase in Periodicals postage would increase total Postal Service revenue by *less than one percent*.

**Figure 4. An Existential Threat to an Industry;
A Drop in the Bucket to USPS (Dollars in Billions)**



Source: Library Reference ANM *et al.*--LR--RM2017-3/4, Figure 4.

In fact, the loss of mail volume caused by the proposed rate increases would likely be large. Our comments in Phase I included extensive analysis of the effects of above-CPI price increases on mail volume. *See* Cohen Decl. (Mar. 20, 2017) at 5–8; Faust Decl. ¶ 12. The results illustrated the dramatic effect that rate increases much smaller than those now proposed by the Commission would have on the publishing industry:

Publisher responses dramatically illustrate the damage that postage increases will have on our industry. At CPI plus 10 percent, publishers estimated their Periodicals volume would decrease by 27 percent. At CPI plus 15 percent, the impact was even more dramatic, with survey respondents estimating volume decreases of 34 percent. Following compilation of the survey results, I summarized the responses at a meeting of the MPA Executive Committee. I told the members what the survey showed with respect to potential volume declines in the event of rates increases as big as CPI plus 10 percent and CPI plus 15 percent. I informed the members that the PRC has generally estimated that postal volumes are relatively inelastic, meaning that volumes decrease less than rates increase in the event of a rate change. Despite that, the group believed that the volume falloff could be even larger than survey responses indicated. Pressure on their business models, based on the recent changes

in the media ecosystem, have left them much less room to withstand significant increases in any part of their business.

Cohen Decl. at 6–7. Magazine publishers would respond to the increases by closing titles, going digital only, cutting circulation or frequency, and reducing staffing. Cohen Decl. at 5–7; Faust Decl. at ¶ 12 (Time Inc.).

Based on the price sensitivities revealed by last year’s survey, the much larger Periodicals rate increase proposed by the Commission in Order No. 4258—24-30 percent above inflation over a five-year period—would, by itself, cut Periodicals volume (and the related First-Class, Marketing and package volume) more than in half and cause many magazines to close or cut frequency and circulation:

Table 2. Response of Publishers to PRC-Proposed Rate Increase

Response If Periodicals Rates Increase By...	24% Above Inflation	30% Above Inflation
Close magazine	35%	44%
Go digital only	22%	28%
Cut frequency	35%	44%
Decrease paper weight and/or grade	53%	66%
Reduce trim size	27%	34%
Cut circulation	37%	46%
Increase use of alternate delivery	30%	38%
Reduce staffing	94%	100%

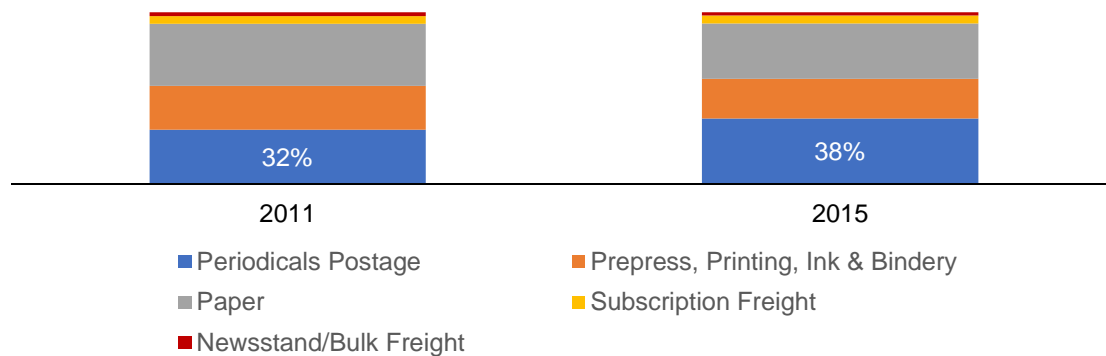
Source: Library Reference ANM *et al.*--LR--RM2017-3/4, “Table 2.”

These effects are much larger than those resulting from the temporary exigent increase. The magnitude of the rate increase proposed in Order No. 4258 is between five and six times larger than the exigent rate increase.

Moreover, the PRC-proposed rate increase will last at least five years and will likely be built into the base for future rate increases and thus effectively be permanent.

In evaluating the justness and reasonableness of the Commission-proposed rate increases, it is important to keep in mind that recent increases in postage rates have far outstripped the increases in the costs of all other major inputs incurred in the manufacturing, production, and distribution of periodicals (“MPD costs”), even though suppliers of other inputs face similar declines in volume as the Postal Service. For example, postage costs increased from 32 percent of MPD costs in 2011 to 38 percent in 2015:

Figure 5. Manufacturing, Production, and Distribution (2011 v 2015)



Source: Library Reference ANM *et al.*—LR—RM2017-3/4, “Figure 5”.

This trend has continued since 2015. A major publisher has calculated that the share of its total manufacturing, production, and distribution costs represented by postage increased by nine percent from 2015 to 2017.

The injury to publishers likely to result from the rate increases contemplated in Order No. 4258 is additionally problematic in light of Factor

11, the longstanding provision that requires consideration of “the educational, cultural, scientific, and informational value [of Periodicals].” 39 U.S.C. § 3622(c)(11). The statutory rate preference for mail matter with ECSI value, which predates PAEA, codifies “the preferential rate treatment historically accorded periodicals to foster, among other things, diversity of views and nationwide availability, i.e., the widespread dissemination of information.” Order No. 1446 in Docket No. C2004-1, *Complaint of Time Warner Inc. et al. Concerning Periodicals Rates* (Oct. 21, 2005) at App. A, p. 2; see generally *id.*, App. A at 1–20.

Nonprofit Marketing Mail: For nonprofit mailers of Marketing Mail, above-CPI rate increases would have a “crippling effect” on organizational effectiveness, forcing cutbacks in “fundraising appeals and renewals, magazine, and other important publications” and conversions to “alternative channels of communication,” a move that would “greatly impair” the ability of nonprofits to carry out their qualifying nonprofit missions. Brophy Decl. at ¶ 11 (Consumer Reports); Burgoon Decl. at ¶¶ 7–10 (Disabled American Veterans); Finstad Decl. at ¶¶ 9–10 (American Lung Association); Maio Decl. at ¶ 12 (National Wildlife Federation); O’Sullivan Decl. at ¶ 8 (Guideposts). Many, perhaps most, nonprofits rely on mail to raise the majority of their revenue. Some raise all or nearly all of their funds through the mail.

Nonprofit industry watchdogs that evaluate charities (e.g., Charity Navigator, Consumer Reports, the Better Business Bureau, Charity Watch, and Guidestar) have a major influence on donors’ decisions about which charities to support. These ratings agencies encourage donors to consider the

percentage of revenue that charities spend on program expenses, and discourage support for charities with higher overhead and fundraising expenses. To compete effectively for donations, nonprofits need to keep their overhead below acceptable levels (typically between 25 and 35 percent). Nonprofits thus face real pressure to keep their fundraising expenses, of which postage costs are a large part, low.³⁹

If postage rates were to increase faster than normal inflation, most nonprofits would be forced to reduce mailings and receive less revenue. This would have a direct impact in their programmatic missions. Five years or more of upward spiraling postage rates would cause devastating harm to the nonprofit sector and weaken its ability to deliver beneficial and needed services and aid to the public. The Commission has received dozens of comments and letters from nonprofits in this and other proceedings that verify these facts.

Commercial Marketing Mail Flats: For-profit mailers and mail service providers would be harmed by the proposed above-CPI rate increases as well, curtailing marketing campaigns, reducing services, and passing costs on to customers and consumers (leading to further reductions in mail volume). Smith Decl. at ¶ 4 (Publishers Clearing House); Rosser Decl. at ¶ 5 (IWCO Direct).

³⁹ For example, to meet Charity Watch's criteria for high efficiency, a charity must spend at least 75 percent of its expenses on program services (and, thus, less than 25 percent of its expenses on overhead). The Better Business Bureau's Wise Giving Alliance expects charities to spend at least 65 percent of expenses on program services, and no more than 35 percent on fundraising.

These harms would be exacerbated because the proposed rate increases would not occur in a vacuum. As further described in our initial comments, while most inputs used by mailers have become less costly since 2007,⁴⁰ the one core cost that has increased annually during the past decade for most mailers is postage. Faust Decl. at ¶¶ 6, 8; Smith Decl. at ¶ 6.⁴¹ See ANM *et al.* March 2017 Comments at 71. That is, mailers and mail service providers have been able to absorb postage increases, including during the exigency surcharge, by cutting costs for other inputs and becoming more productive in other aspects of their business. This process can only carry on so long. If the cost of postage begins to increase at rates much higher than CPI, the industry will not be able to cut costs in other areas drastically enough to keep pace. Alternative media channels will become more attractive, or, in some cases, the cost of doing business will simply become too high, and the mailer will shut down entirely. This danger is especially acute for mailers of Periodicals and Marketing Mail Flats, which face potential rate increases of at least 40 percent under the Commission’s proposal.

Finally, the proposed “noncompensatory” surcharge for Marketing Mail Flats would generate no additional revenue at all because it would be offset by lower increases on other Marketing Mail products. See proposed 39 C.F.R.

⁴⁰ See, e.g., Faust Decl. at ¶¶ 6, 8; Rosser Decl. at ¶ 10 (relating how IWCO Direct, a mail service provider, reduced its prices in response to client demand).

⁴¹ In addition to postage increases, the costs of complying with Postal Service requirements has increased as well, as the Postal Service has shifted certain mail preparation and entry costs to mailers. See Rosser Decl. at ¶¶ 11–15; Faust Decl. at ¶ 9.

§ 3010.201 (“This section does not create additional rate authority applicable to any class of mail.”).

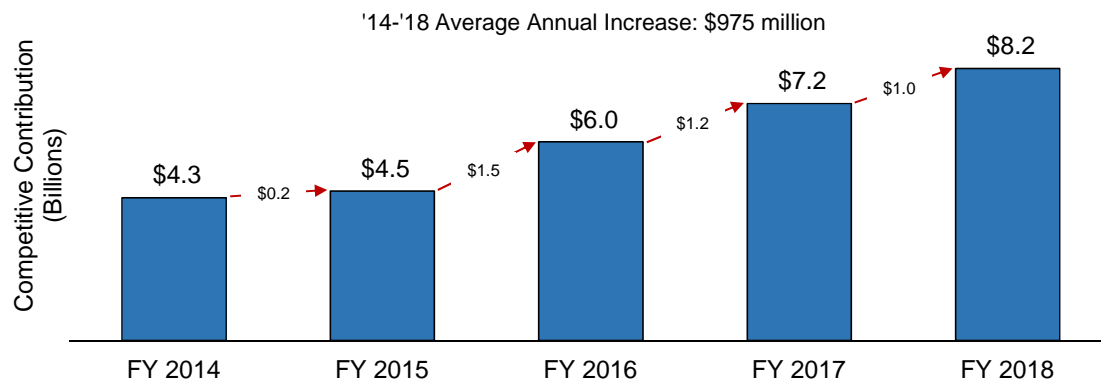
E. The Commission’s analysis of Objective 5 (revenue adequacy or financial stability) is flawed.

As discussed above, Order Nos. 4257 and 4258 have improperly elevated Objective 5, financial stability, over all other statutory objectives. Moreover, even Section 3622(b) allowed this priority, the Commission has grossly misapplied Objective 5 on its own terms.

(1) The Postal Service has achieved short-run financial stability, as the Commission acknowledges. *See* Order No. 4257 at 4 (“[T]he Postal Service has generally achieved short-term financial stability”); *id.* at 162 (detailing operating profit in Table II-7). As noted above, the Postal Service holds more than \$10 billion of cash, and has been generating about \$3 billion in additional cash from operations each year. USPS Form 10-K for Fiscal Year 2017, at 48.

(2) The Postal Service’s *longer-term* financial prospects are far brighter than the Commission portrays in Order No. 4257. In particular, the contribution generated by delivering packages in e-commerce has been increasing rapidly, by an average of about \$1 billion per year.

Figure 6. Competitive Product Contribution (FY 2014 – FY 2018)



Source: Library Reference ANM *et al.*—LR—RM2017-3/4, “Figures 6 & 7”.

These trends are predicted to continue. According to a 2016 eMarketer projection, retail ecommerce sales will experience double-digit growth until 2021. See eMarketer report, *Worldwide Retail and Ecommerce Sales: eMarketer’s Updated Forecast and New Mcommerce Estimates for 2016–2021* (Jan. 29, 2018). Similarly, according to Statista, e-commerce revenue in the U.S. is forecasted to grow 12.6 percent in 2018 (\$474.5 billion) and 11.1 percent in 2019 (\$526.9 billion) from \$421.1 billion in 2017; while retail e-commerce sales in the U.S. is expected to grow to \$461.6 billion in 2018, \$513.5 billion in 2019, and \$561.5 billion in 2020. Furthermore, Forrester predicts that online sales will account for 17 percent of all U.S. retail sales by 2022, up from a projected 12.7 percent in 2017. See *Forrester Data: Online Retail Forecast, 2017 To 2022 (US)*, FORRESTER REPORT (Aug. 1, 2017). Wal-Mart, alone, projects that its U.S. e-commerce business will grow sales by roughly 40 percent in fiscal 2019. See Lauren Thomas, *Wal-Mart Calls for 40 Percent e-commerce Sales Growth in Fiscal Year 2019*, CNBC (Oct. 10, 2017) available at <https://www.emarketer.com/Report/Worldwide-Retail-Ecommerce-Sales->

[eMarketers-Updated-Forecast-New-Mcommerce-Estimates-20162021/2002182.](#)

The undersigned parties examined this trend at length in their comments last year. ANM *et al.* March 2017 Comments at 26–32. The Commission, after acknowledging that the contribution from competitive products is growing, Order No. 4258 at 29, simply assumes in the Commission’s shortfall analysis that the future contribution from competitive products will never exceed the current level, and that the Postal Service must close its revenue shortfall entirely through rate increases on market-dominant mail products. *Id.* at 41 n. 58.

This assumption is indefensible. A reasoned assessment of the Postal Service’s finances in the medium and long run must reflect the projected contribution from both competitive and market-dominant products. Both sets of products use the Postal Service network; both contribute to its institutional costs; and PAEA requires both to do so. Order No. 4257 at 246; Order No. 4402 in Docket No. RM2017-1, *Institutional Cost Contribution Requirement for Competitive Products* (Feb. 8, 2018) at 52; 39 U.S.C. §§ 3622(b)(9), 3633(a)(3), 3633(b). “Any revenues provided by competitive products above their attributable costs advances [sic] the achievement of the Postal Service’s financial stability.” USPS Comments (Mar. 20, 2017) at 78. Hence, ignoring the likely growth in contribution from competitive products would require

market-dominant products to bear an unjustly high share of institutional costs. That would violate Sections 404(b), 3622(b)(8) and 3622(b)(9).⁴²

The Commission may not ignore the projected growth in contribution from competitive products on the theory that the growth may slow eventually. *Cf.* USPS Comments (Mar. 2017) at 115 n. 216. Analysis of the Postal Service's future financial stability requires that the Commission estimate the future value of many relevant revenue and cost variables (*e.g.*, future volumes, competition, inflation, and interest rates), none of which can be known with certainty today. The only sensible approach, as with any projections of this kind, is to rely on the best evidence of record available today.⁴³ The best current evidence shows that the revenue and contribution from competitive products will continue to grow for the foreseeable future. *See* pp. 71-73, *supra*; *accord*, ANM *et al.* March 2017 Comments at 30–34.

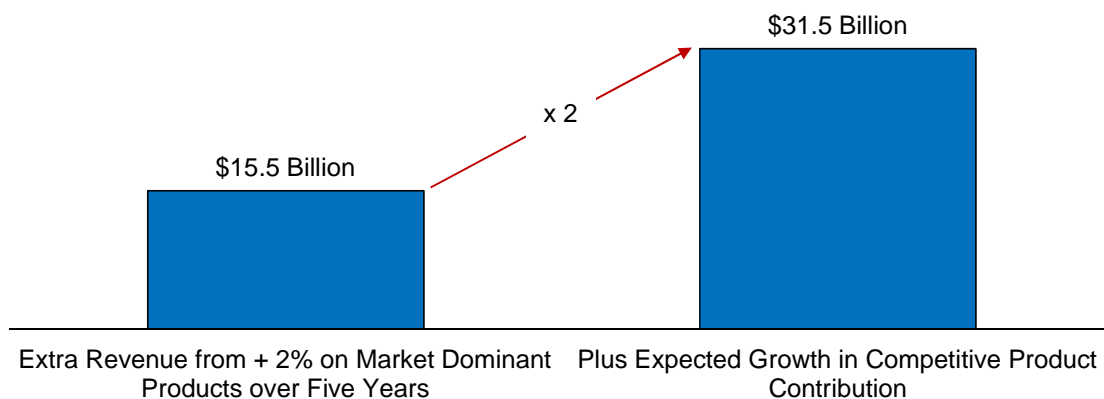
⁴² The Interstate Commerce Commission and the Surface Transportation Board have held, in the analogous context of setting maximum rates for the market-dominant transportation of coal by railroad, that a coal shipper is entitled to offset the expected contribution from other market-dominant and competitive traffic against the railroad's fixed and common costs; otherwise "the captive shipper would be deprived of the benefits of any inherent production economies." *Coal Rate Guidelines—Nationwide*, 1 I.C.C.2d 520, 544 (1985), *aff'd*, *Consolidated Rail Corp. v. United States*, 812 F.2d 144 (3d Cir. 1987).

⁴³ *See, e.g., Burlington N. R. Co. v. STB*, 114 F.3d 206, 212–13 (D.C. Cir. 1997) (upholding decision of the Surface Transportation Board, in setting maximum rates for market-dominant coal transportation, to consider the best evidence of record concerning the effect of competitive, volume and price trends that would influence the future contribution from other freight volume over the expected life of the railroad); *Bituminous Coal—Hiawatha, Utah, to Moapa, Nevada*, 10 I.C.C.2d 259, 268–71 (1994) (same).

In any event, if the projections prove inaccurate in the future, the Commission can revisit its findings: the Postal Service’s short-run financial stability avoids any need for the Commission to act precipitously now. By contrast, if the Commission overcharges mailers in the short-term to protect against the speculative possibility that the growth in the Postal Service’s contribution from competitive products may reverse itself, the injured mailers can never be made whole.

The error created by ignoring the projected growth in contribution from competitive products is large. Over the five-year term of the proposed surcharges, that contribution growth is projected to equal the *entire amount* of the projected contribution from the proposed two percent “supplemental rate authority” over the same period:

Figure 7. Ignoring Competitive Product Contribution Growth Charges USPS Customers Twice



Source: Library Reference ANM et al.–LR–RM2017-3/4, “Figures 6 & 7”.

(3) While the current reported net earnings of the Postal Service are still negative and the Postal Service still has “accumulated deficits” in the post-

PAEA era, the Commission admits that these shortfalls are due largely to the accelerated prefunding obligations imposed by PAEA, not to operating losses. *See* Order No. 4257 at 171 (“The accumulated deficit of \$59.1 billion includes \$54.8 billion in expenses related to prefunding the RHBF”). As we showed in our March comments, the prefunding obligations are no measure of the Postal Service’s actual ability to honor its obligations to its retirees. *See* ANM *et al.* March 2017 Comments at 40–44. In fact, even as the Postal Service has stopped prefunding these obligations, its retiree benefit programs remain better funded than the vast majority of public and private sector retirement programs.

Figure 8. Pension Funding Levels

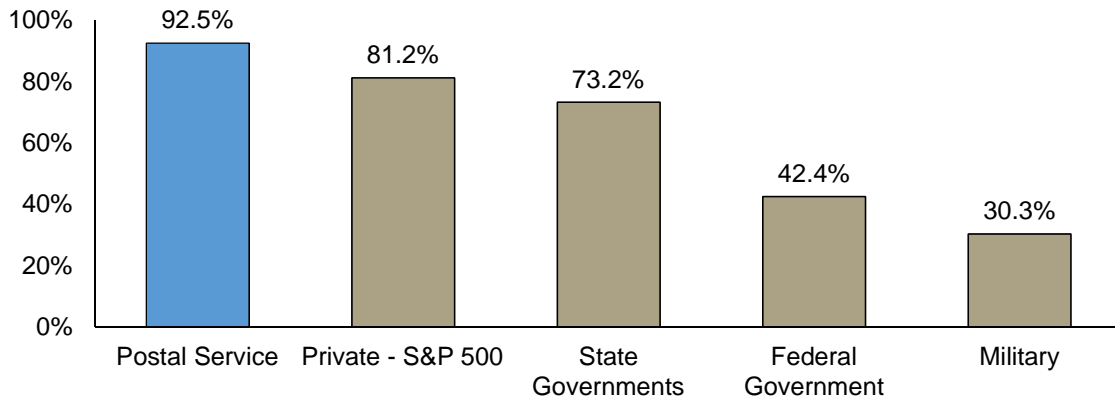
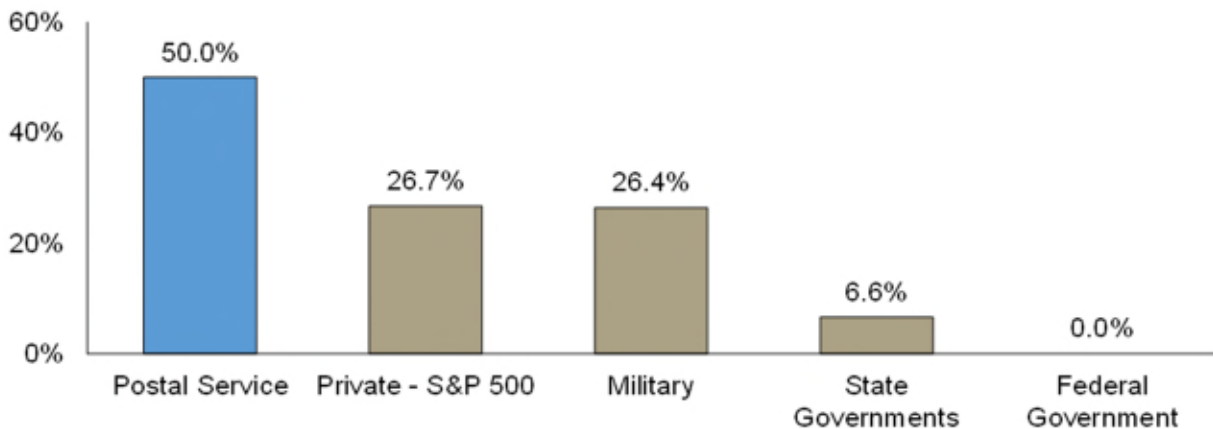


Figure 9. Retiree Health Care Prefunding Levels



Source: Nadol Decl. at 3–5, 12–23; *see also* ANM *et al.* March 2017 Comments at 40–44. In Order No. 4258, however, the Commission has calculated the shortfall that must be recovered from above-CPI surcharges as if the statutory funding schedule is immutable even though the Postal Service has not met it, and the Congress and the Administration have taken no action to force the Postal Service to comply with it. The status accorded by the Commission to the nominal prepayment schedule elevates formalism over financial reality.

(4) In their March 2017 comments, the undersigned parties identified a number of other steps that the Postal Service could take to improve its finances. ANM *et al.* March 2017 Comments at 47–63. Some of these steps would require Congressional action, but others would not. The latter would include (a) taking measured steps toward compliance with the existing pay comparability requirement, (b) reviving the cost reduction initiatives that the Postal Service abandoned in Fiscal Year 2014 (not coincidentally, the year when the exigent surcharge authorized in R2013-11 took effect), (c) making better management and pricing decisions (*e.g.*, abandoning the Flats Sequencing System (“FSS”) and establishing appropriate worksharing discounts), and (d) looking creatively for new revenue sources as well-run businesses do. ANM *et al.* March 2017 Comments at 47–57.

As shown in the roll-forward analysis included with our March 2017 comments, the Postal Service could have improved its annual controllable operating income between Fiscal Year 2015 and Fiscal Year 2019 by approximately \$2.7 billion just by limiting its cost increases to the rate of inflation. *Id.* at 33; *see also* Library Reference ANM *et al.*-LR-RM2017-3/1,

Rollfwd.xlsx. In Order No. 4258, however, the Commission has ignored all of the alternative sources of extra revenue and cost savings identified by the mailers.

(5) Even if the Commission were entitled to ignore all alternative ways to reduce or eliminate the Postal Service's revenue shortfall, the *gross* amount of the revenue shortfall appears to have been pulled out of thin air. The Commission began its analysis with the \$2.7 billion in losses (including prefunding obligations that the Postal Service never paid) ostensibly incurred by the Postal Service in Fiscal Year 2017. *See* Order No. 4258 at 40–41. After noting, however, that factors “such as changes in inflation, the cost of inputs, changes in operational efficiency, secular volume trends, and mailers’ responses to price changes” could affect the Postal Service’s future financial position, the Commission states that “it is not possible to precisely calculate the exact amount of additional pricing authority that will achieve medium-term stability.” Order No. 4258 at 41. Thus, while the Commission proclaims that “the proposed supplemental rate authority is designed to provide the opportunity to generate additional revenue that is sufficient, when combined with cost reductions and operational efficiency gains, to improve the financial stability of the Postal Service,” *id.*, the total assumed shortfall is not derived from any actual projection of the Postal Service’s future revenues and costs.

As a result, the Commission does not (and could not) explain why rate increases equal to CPI + 2% would be “sufficient,” but CPI + 1% would not. The Commission also does not explain what level of cost reductions or operational efficiency gains must be combined with this additional authority, an especially

egregious oversight since the Commission has simultaneously weakened the incentives for the Postal Service to engage in these activities. Additionally, the Commission has performed no econometric studies to model the volume effect of a CPI + 2% price increase versus other potential increases. In short, the Commission provides no justification for *this* level of supplemental rate authority as opposed to any other level.

In this respect, the two percent additive is akin to the seven percent additive above fully allocated costs that the Interstate Commerce Commission authorized in 1979 to enable western railroads to avoid under recovery of their equivalent of institutional costs. Every court that reviewed the ICC approach struck it down as arbitrary and capricious. As the D.C. Circuit explained in 1980, the ICC

did no more than make the general assertion that it could not find that the railroads had achieved revenue adequacy. There is nothing in the record in the way of findings, evidence, or rationale to support the seven percent solution or any percentage solution. The Commission's general allusion to the need to consider the revenue requirements of the carriers and the economics of differential pricing is so broad as to be meaningless as a standard — this rationale could be put forth just as readily in an attempt to justify a 1%, 21%, 45%, or even a 99% additive. The Commission here defends its action on the ground that adoption of the appropriate additive involves a policy judgment that is not susceptible to precise quantification. Concededly the problem is a difficult one, but that does not excuse the Commission from articulating "fully and carefully the methods by which, and the purposes for which, it has chosen to act."

San Antonio, Texas v. United States, 631 F.2d 831, 852 (D.C. Cir. 1980).

(6) In any case, the Commission's attempt to guarantee the Postal Service financial stability by providing it with additional revenue is a fool's

errand. If the Postal Service's financial prospects were truly as dire as the Commission contends, the rate increases contemplated in Order No. 4258 could not solve the problem. "[W]hen a regulated industry is in financial trouble . . . there is nothing a regulator can do to guarantee a 'fair rate of return.'" WILLIAM J. BAUMOL AND ALAN S. BLINDER, MICROECONOMICS: PRINCIPLES AND POLICY at 442 (7th ed. 1998). If the regulator attempts to solve the firm's problems by raising prices, the higher prices will simply cause the firm to lose more business and its profits will drop further. *Id.*

In fact, the price increases contemplated by Order No. 4258 are more likely to worsen the Postal Service's finances than improve them. The Commission recognizes that its estimates of the future revenues its supplemental rate authority proposal will provide assume that volume will remain constant. Order No. 4258 at 42. And the Commission admits that this assumption is inconsistent with "recent volume trends and the effects of price elasticity." *Id.* Yet the Commission simply assumes away this problem, stating that "it intends for the Postal Service to achieve cost reductions and operational efficiency gains sufficient to close the gap between total revenue and total costs." *Id.* at 43.

The Commission has underestimated the effect of its proposed rate increases. The falloff in volume and revenue is likely to be much larger than the Postal Service has experienced to date, and could even set off a death spiral. *See pp. 64-70, supra.* This effect does not appear in existing elasticity data because postal price increases of this magnitude have not occurred in recent decades. As shown in Table II-4 of Order No. 4258, "price changes over time

[during the PAEA era] were relatively consistent with the overall change in CPI-U.” Order No. 4258 at 121. In other words, prices stayed essentially flat in real terms.

The Commission has not seriously considered the likely effect of its proposals on volume. Simply assuming the Postal Service will make sufficient productivity gains to offset the declines in volumes the rate increases will cause is not enough. There is no basis for believing this to be so, especially since the Commission’s proposals remove the Postal Service’s incentives to engage in cost reduction and efficiency improvements. Moreover, the analysis (such as it is) does not account for the multiplier effect, which is especially important for catalogs and magazines. *See Op. and Rec. Decis., Docket No. MC2005-3, Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bookspan* (May 10, 2006) at 3, 6, 9, 43, 45, 50–53, 80. If catalogs and magazines leave the mail, the Postal Service will lose not just that volume, but the invoice and fulfillment volume it generates.

In sum, the Commission is shortsightedly trying to guarantee the Postal Service additional revenue while ignoring the significant volume impacts its radical and unprecedented rate increases are likely to have. Rather than foster a “harmonious cycle,” the proposed rate increases will likely lead to a death spiral—exactly the situation PAEA was intended to avoid. *See also* Cong. Rec. S11674 (Dec. 8, 2006) (Sen. Collins) (supporting a price cap to avoid “a potential death spiral in which escalating rates lead to lower volume, which in turn leads to even higher rates, which in turn causes the Postal Service to lose more

business.”; *accord* Cong. Rec. H6513 (July 26, 2005) (Chairman Davis comments on H.R. 22).

F. The Commission’s treatment of Objective 3 (high quality service standards) is arbitrary.

The Commission’s analysis of Objective 3, “to “maintain high quality service standards established under section 3691” (39 U.S.C. § 3622(b)(3)), is also arbitrary.

(1) The Commission invokes Objective 3 to buttress Objective 5, asserting that criticisms of the Postal Service’s “service performance over the past 10 years” are evidence that the Postal Service has failed to achieve financial stability. *See, e.g.*, Order No. 4257 at 259–60. But the Commission ignores the qualification of Section 3691 that service quality cannot be assessed in isolation, but must be evaluated in conjunction with the cost of services and their net value to senders and recipients. 39 U.S.C. § 3691(b)(1) (directing that service standards be designed to “enhance the value of postal services to both senders and recipients”); 39 U.S.C. § 3691(b)(1)(C) (to “reasonably assure Postal Service customers delivery reliability, speed and frequency *consistent with reasonable rates* and best business practices”) (emphasis added); 39 U.S.C. § 3691(c)(6) (to take into account “the current and projected future cost of serving Postal Service customers”). Service performance quality is not a free good. If cost were no object, mailers would want overnight delivery for nearly everything. That Express Mail (and competing private delivery services) carry only a fraction of all letters and

packages confirms that faster and more reliable service is not better than slower or less reliable service unless the benefits outweigh the added costs.⁴⁴

The Commission has apparently conducted no such cost-benefit analysis, rather simply pulling from the record any statement by any commenter, whether or not a user of market-dominant products, that faster and more consistent service would be better than the opposite. Order No. 4257 at 257–73. The Commission does not appear to have asked whether the American people, as mailers, consumers and taxpayers, are in fact willing to pay enough for the faster and more consistent service to cover its cost.

(2) In Order No. 4258, the Commission proposes to allow the Postal Service to collect an additional annual surcharge, dubbed a “Performance Incentive Mechanism.” Under this proposal, the Postal Service could impose an extra 0.25 percent rate increase on a market-dominant class each year if the Postal Service maintains or improves the nominal service standards for the class. Order No. 4258 at 70-73. The proposal is completely arbitrary.

First, the surcharge is tied not to actual service performance, but to the published standards, which the Postal Service may or may not achieve. The Postal Service will be allowed the additive merely for the performance that it predicts, regardless of whether this is actually achieved. The Commission

⁴⁴ The performance of the passenger airline industry before deregulation also illustrates how consumers can be harmed by regulation that causes service quality to exceed what consumers would voluntarily pay for. See, e.g., 2 Alfred E. Kahn, *The Economics of Regulation* 209–220 (1971) (describing harms of excessive non-price competition by airlines before the deregulation of passenger air fares); Stephen Breyer, *Regulation and its Reform* 205 (1982) (same).

proposes to continue relying on its annual compliance review mechanism to oversee actual service performance. Order No. 4258 at 71–72. This is the same enforcement mechanism that has produced the service performance that the Commission describes in Order No. 4257 as declining and degraded. Order No. 4257 at 250–63. The Commission proposes no new enforcement mechanism that would change this.

Second, allowing the Postal Service to collect extra revenue from captive mailers without a showing that the Postal Service is maximizing its operational efficiency and minimizing its costs would violate Objectives 1, 2 and 8 even if the proposed mechanism were modified by conditioning it on enforceable actual performance. The objective of incentive ratemaking is to offer the Postal Service the prospect of gaining additional profits by reducing its costs while holding service quality constant. We are unaware of any regulatory system that gives a regulated monopoly a financial participation trophy merely for holding its service constant without reducing its costs.

III. THE EXTRA SURCHARGES PROPOSED FOR PERIODICALS MAIL AND MARKETING MAIL FLATS ARE UNLAWFUL.

In Order No. 4258, the Commission proposes that prices for “non-compensatory” products—*i.e.*, products whose revenue is found not to cover attributable costs—shall be increased by a “minimum of” two percentage points annually *in addition to* the above-CPI increases proposed elsewhere in Order No. 4258. At 77; proposed 39 C.F.R. § 3010.201. When the Commission finds that an entire class of mail is noncompensatory on average, the annual surcharge would be fixed at *exactly* two percentage points for the class as a

whole—again in addition to the above-CPI price increases proposed elsewhere in Order No. 4258. *Id.* at 84-86; proposed 39 C.F.R. § 3010.202. Combined with the other above-CPI surcharges proposed by the Commission, these extra surcharges would saddle mailers of periodicals and Marketing Mail Flats with cumulative five-year price increases of as much as *40 percent* if the CPI rises by two percent each year. *See* pp. 9-10, *supra*.

Here again, the Commission has erred by ignoring the pro-mailer objectives of Section 3622(b), the Commission’s own findings during the past decade (most recently in October 2017) about the Postal Service’s management failures in controlling the cost and improving the productivity of flats handling, and the substantial evidence in Phase 1 of this case about the actual causes of the Postal Service’s losses.

The failure of Periodicals Mail and Marketing Mail Flats to cover attributable costs is a cost-control problem, not a revenue problem. Rates for these products have increased as fast as the CPI since 2007, and flat-shaped mail has been increasingly workshared before entry. These two trends should have made Periodicals Mail and Marketing Mail Flats compensatory. Instead, the unit transportation and carrier costs of flats have skyrocketed and mail processing productivity has collapsed.

This dismal performance has resulted from a series of Postal Service management bumbles. These include (1) failing to scale down its operations in response to declines in mail volume; (2) making and then doubling down on a misguided investment in the Flats Sequencing System (“FSS”) against the advice of mailers and many within the Postal Service’s own management; (3)

deliberately mispricing Carrier Route Basic flats, a strategy that has stifled the potential growth in co-mailing, and encouraged inefficient mail preparation; and (4) failing to address the Postal Service's longstanding personnel compensation issues. Eliminating these unforced errors would allow flats to become fully compensatory, or nearly so—even without considering the related contribution from First-Class Mail, letter-shaped Marketing Mail and package volumes that periodicals and catalogs generate.

As with the other proposed surcharges, the Commission's proposed focus on revenue enhancement to the exclusion of cost control, efficient operation, rate stability, and ratepayer protection is a clear violation of Objectives 1, 2 and 8, and cannot be excused by invoking Objective 5.⁴⁵

A. The Postal Service, not its captive customers, is causing the losses on Periodicals Mail and Flat-Shaped Marketing Mail.

Since 2007, the Postal Service's performance in handling flat-shaped mail has been abysmal. As flats volume has declined over the last decade, the Postal Service has not sufficiently rightsized its network, resulting in excess capacity, declining productivities and increasing unit costs. We first discuss the effect of these problems in the context of Periodicals and then apply similar analysis to Marketing Mail Flats.

⁴⁵ Further, regardless of what entity is responsible for causing the losses, Congress intended that the Postal Service should not be allowed to recover its losses under a price cap system outside of extraordinary circumstances. *See* H.R. Rep. No. 109-66, Part 1, at 43–44 (2005) (“In the same way, losses could not be recovered by increasing rates beyond specified parameters without regulatory approval.”).

1. **During the past decade, the costs of handling flat-shaped mail have skyrocketed, while Postal Service productivity has plummeted.**

Sorting: Postal Service sorting productivity in key flat and bundle sorting operations has declined by 29 percent since 2007, increasing Periodicals Outside County attributable mail processing costs by 5.2 cents per piece. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Table 3”, cell D30.⁴⁶ The Commission has acknowledged this trend. In the last two Annual Compliance Determinations, the Commission has identified the huge declines – ranging from 24 percent to 52 percent⁴⁷ – in productivity for key flat sorting operations over the last decade as a major issue. In the FY 2015 ACD, the Commission stated:

One of the major issues causing the increased cost of flats is the decline in productivity on automated equipment. Over the past decade, the productivities measured in pieces per hour (pph) for these machines [SPBS/APBS, APPS, AFSM 100⁴⁸] declined. When productivities go down, the cost efficiency of the Postal Service’s operations declines.

Annual Compliance Determination Report, Fiscal Year 2015, at 168.

In Fiscal Year 2016, the Commission referred to and updated its earlier statements:

⁴⁶ The cost analyses discussed in this section focus on the Outside County product because it represents 95 percent of the Periodicals class revenue. Docket No. ACR2017, USPS-FY17-1, Public_FY17CRARReports.xlsx, “Cost1”.

⁴⁷ Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 10”, cells H10 and H12, respectively.

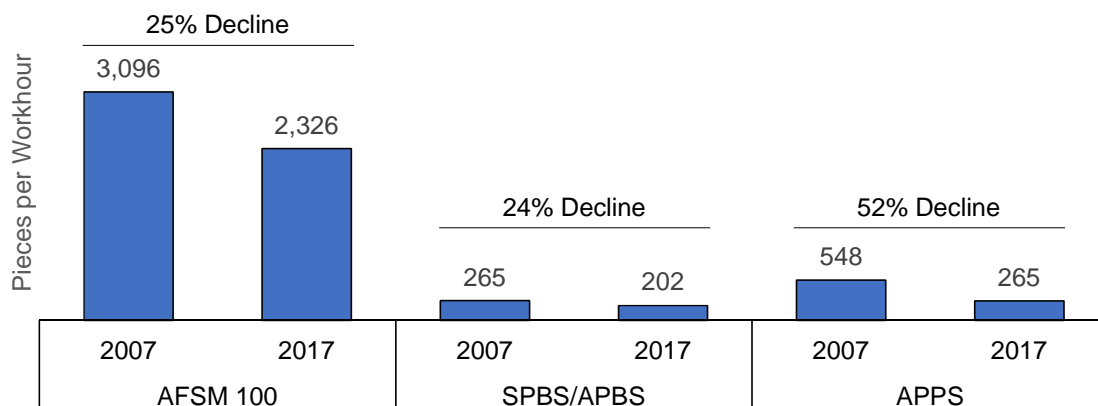
⁴⁸ Small Parcel Bundle Sorter / Automated Parcel and Bundle Sorter (Incoming), Automated Package Processing System (Incoming), Automated Flat Sorting Machines 100 (Incoming Secondary).

In FY 2015, the Commission found that the primary machines used to process flats . . . had declining productivities. . . . [T]hese productivities continue to decline, which leads to reduced operational efficiency of the Postal Service.

Annual Compliance Determination Report, Fiscal Year 2016, at 165-166.

On average, flat sorting productivity in these operations declined by 29 percent over the last decade. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 10”, cell I8. Applying this figure to all mail processing costs, the lower productivity has increased FY 2017 Periodicals Outside County attributable cost per piece by 5.2 cents. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Table 3”, cell D30. Indeed, applying the productivity decline in these flat sorting operations to all mail processing costs may result in an understated adjustment, because “[t]he productivity of allied operations has declined and this decline has negatively impacted both the cost and service performance for flats [T]he costs of preparing and moving the mail for processing increased faster than the cost of processing.” FY 2015 ACD at 173.

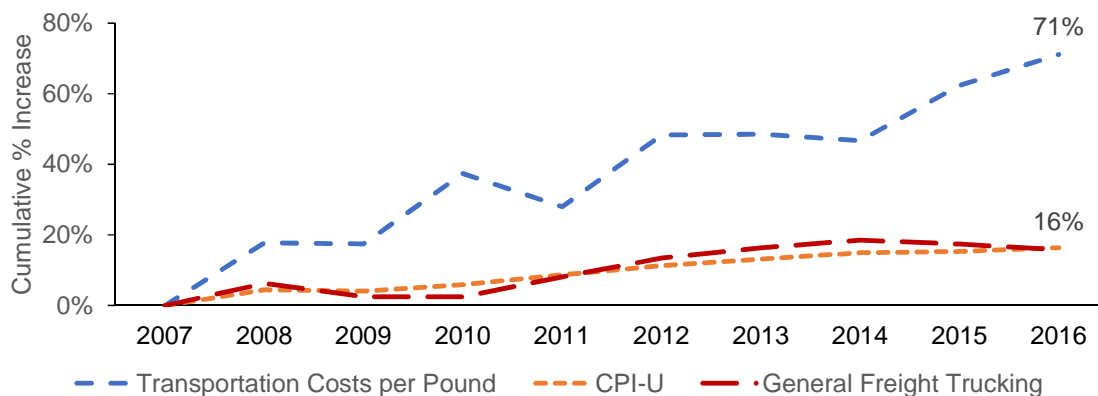
Figure 10. Key USPS Flat Sorting Machine Productivities



Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 10.”

Transportation costs. Since 2007, Periodicals Outside County attributable transportation cost per pound has increased by 71 percent⁴⁹, an increase more than four times the rate of inflation, despite the growing percentage of Periodicals Outside County mail being entered at DSCF/DFSSs. See Figure 11. This trend increased FY 2017 Periodicals Outside County cost per piece by 1.4 cents per piece. Library Reference ANM *et al.*–LR–RM2017–3/4, “Figure 15 & Table 3”, cell D31.

Figure 11. Percent Increase in Periodicals Outside County Transportation Costs per Pound v. Inflation⁵⁰



Source: Library Reference ANM *et al.*–LR–RM2017-3/4, “Figure 11.”

The Commission has acknowledged this trend. In the FY 2016 ACD, the Postal Service found, “[i]n the past 4 years, [per-piece attributable transportation costs for flats] have increased 26.5 percent From Fiscal Year 2015 to Fiscal Year 2016, unit transportation costs increased 11.6

⁴⁹ Library Reference ANM *et al.*–LR–RM2017-3/4, “Dropship Data”, cells E16 and F16, respectively.

⁵⁰ FY 2017 excluded due to change in costing method.

percent. The Postal Service has not provided an explanation for this large increase in unit costs.”⁵¹

Delivery and carrier costs. Since 2007, the Postal Service’s attributable cost per piece to deliver Periodicals Outside County increased at a rate twice the rate of inflation even though FSS shifted workload—sorting flats into delivery point sequence—for some zones from carriers to mail processing clerks. This trend increased the costs attributed to Periodicals Outside County pieces by 2.1 cents per piece. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Table 3”, cell D32.

Despite substantial declines in flats volume and the shift of carrier in-office workload into mail processing operations, the Postal Service has barely cut its carrier *in-office* costs for flats since Fiscal Year 2008. The Commission has acknowledged this:

The unit costs for city carrier in-office processing (casing) were higher in FY 2015 than FY 2008 for the five different flats products When the additional mail processing costs associated with the FSS are added to the city carrier in-office costs, the Postal Service spent over \$1.3 billion processing flats to DPS in FY 2015. This is nearly the amount spent casing flats in FY 2008, when volume was 60 percent higher than FY 2015. In FY 2008, the Postal Service had to manually case all flats because there were no FSS machines. Despite the addition of 100 FSS machines and lower volume, the Postal Service spent nearly the same total amount in processing flats in FY 2015.⁵²

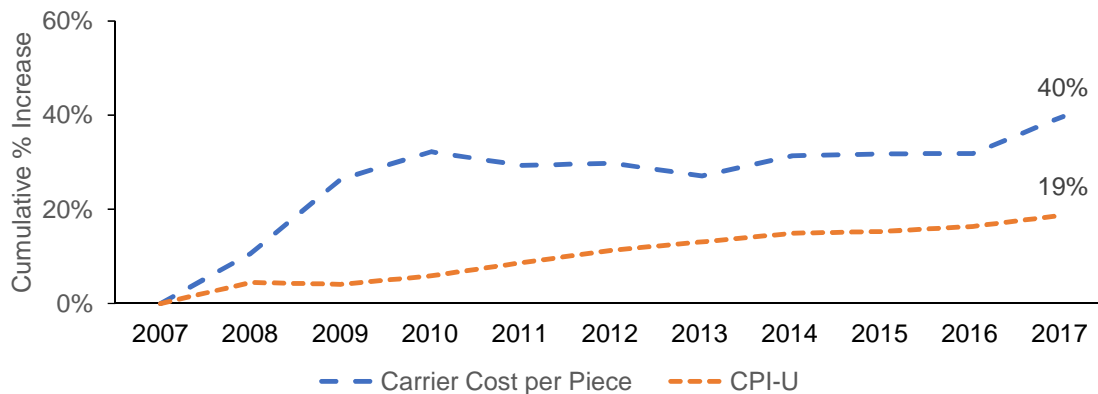
The Postal Service spent a total of \$1.1 billion in city carrier in-office costs, which include casing costs for flats in FY 2016 When the additional mail processing costs associated with the

⁵¹ Annual Compliance Determination Report, Fiscal Year 2016, at 168.

⁵² Annual Compliance Determination Report, Fiscal Year 2015, at 178-179.

FSS are added to the city carrier in-office costs, the Postal Service spent \$1.319 billion processing flats to Delivery Point Sequence (DPS) in FY 2016 This is nearly the amount spent casing flats in FY 2008, when volume was 67 percent higher than FY 2016.⁵³

Figure 12. Percent Increase in Periodicals Outside County Unit Carrier Costs v. Inflation⁵⁴



Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 12.”

2. These adverse cost trends have resulted from needless excess capacity and other avoidable investment and pricing errors by the Postal Service.

These unfavorable cost trends have resulted from unforced errors in investment and pricing. The record on this issue in Phase 1 is extensive, if almost entirely ignored by the Commission in Order Nos. 4257 and 4258. ANM *et al.* March 2017 Comments at 11–12, 54–57, and supporting Declarations of Rita Cohen, Jerry Faust, Michael Nadol (at 11), Michael Plunkett, Quad/Graphics, and Halstein Stralberg.⁵⁵

⁵³ Annual Compliance Determination Report, Fiscal Year 2016, at 168.

⁵⁴ Controlled for FY 2015 change in city carrier costing method.

⁵⁵ As explained in the declaration of Michael Nadol for the undersigned parties in Phase 1 of this case, the Postal Service also has not meaningfully addressed

(1)

Despite concerns raised by the flats mailing industry as well as experts within the Postal Service, it invested in and deployed equipment—the Flats Sequencing System (“FSS”)—that has increased the Postal Service’s cost to sort Periodicals Outside County by 2.8 cents per piece. Library Reference ANM *et al.*--LR--RM2017-3/4, “Figure 15 & Table 3”, cell D29; *accord*, ANMet *al. March 2017* Comments at 55; Stralberg Decl. (March 20, 2017); Plunkett Decl. (March 20, 2017); Library Reference ANM *et al.*-LR-RM2017-3/2. .

The Commission recognized this, if obliquely, in its FY 2015 Annual Compliance Determination:

[The] FSS did not have the intended effect of improving cost or service The inability of the Postal Service to achieve [delivery point sequence] percentages above 81.9 percent creates cost and service issues for flats across all classes and products. However, the Postal Service did not clearly identify the cost or the service impact of the FSS implementation.”⁵⁶

The Commission is correct that the FSS deployment has greatly increased Periodicals costs. As Mr. Stralberg explained a year ago: “[t]he Postal Service took . . . the most efficient portion of the flats mailstream [Carrier Route mail] and turned it into something much less efficient [FSS mail]. Far from reducing flats costs as the Postal Service had hoped, the FSS program has increased those costs significantly, and there is no evidence that

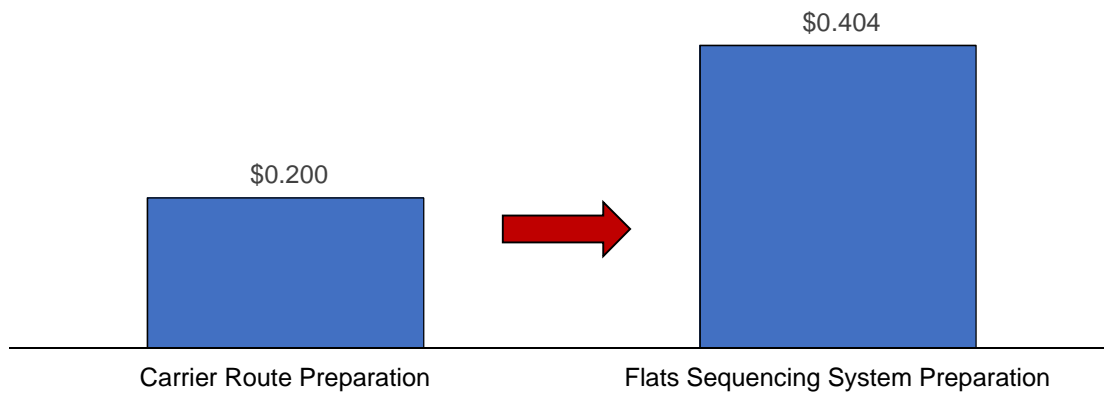
its longstanding compensation issues over the last decade. Cost reductions from doing so would meaningfully lower the Postal Service’s cost to handle Periodicals. Nadol Decl. (Mar. 20, 2017) at 11.

⁵⁶ Annual Compliance Determination Report, Fiscal Year 2015, at 170.

the Postal Service knows a way forward to make the program produce real cost reductions.” Stralberg Decl. at 3.

Given the poor performance of the FSS, the main effect of its deployment has been to force a substantial amount of Periodicals from Carrier Route preparation into FSS preparation and in so doing, doubling the mail processing and delivery costs for this mail.⁵⁷ Library Reference ANM *et al.*–LR–RM2017–3/4, “Figure 13”, cells D32 and D33.

Figure 13. Mail Processing and Delivery Cost of Periodicals Outside County Carrier Route and FSS Flats



Source: Library Reference ANM *et al.*–LR–RM2017-3/4, “Figure 13”.

Averaged across the entire product, the FSS deployment increased FY 2017 Periodicals Outside County cost per piece by 2.8 cents because FSS were not deployed everywhere. Library Reference ANM *et al.*–LR–RM2017-3/4, “Figure 13”, cell D30.

⁵⁷ FSS flats are also more costly for the Postal Service to sort and deliver than 5-Digit Automation flats, but the difference is smaller. Library Reference ANM *et al.*–LR–RM2017-3/4, “Figure 13”, cells E21 and F21.

The Postal Service defended these results on the theory that the FSS “is in its relative infancy, and the Postal Service is still learning about which operational flows will minimize the cost of FSS processing.” Docket No. ACR2016, USPS Report USPS-FY16-44, *Update to Periodicals Pricing Report* (Dec. 29, 2016) at 6. Data recently reported by the Postal Service, however, show that the performance of the FSS is getting worse, not better. In the past two years, the average number of mail pieces processed per machine hour has decreased by eight percent, the proportion of “mail pieces at risk” of jams or other mishaps has risen by eight percent, and the proportion of FSS-zone flats that get fully sorted by the FSS machines has declined nearly 10 percent. Docket No. ACR2017, Response of the USPS to Chairman’s Information Request No. 5, Question 1 (Jan. 26, 2018).

(2)

A third factor that has needlessly inflated the attributable costs of flats is the Postal Service’s deliberate mispricing of Carrier Route Basic flats. Despite serious concerns raised by publishers and the Commission, the Postal Service has reduced the Carrier Route Basic passthrough for Periodicals Outside County flats to 52 percent. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 14”, cell L7. This mispricing has caused—and continues to cause—inefficient mail preparation by mailers and needlessly high costs for Periodicals Mail. *See also* ANM *et al.* March 2017 Comments at 56; Quad/Graphics Decl. (Mar. 20, 2017) at 2–3; Plunkett Decl. ¶¶ 6–8; Stralberg Decl. (Mar. 20, 2017) at 3, 12–14; and Library Reference LR-ANM *et al.*-RM2017-3/2.

The inadequacy of the Carrier Route discount is particularly problematic because the discount is the most important single discount for encouraging efficient preparation and reducing Periodicals costs:

[T]he low passthrough underlying the Carrier Route Basic discount has limited the growth in co-mailing and caused flats processing to be more costly for the USPS than it should be. Passing through the entire Carrier Route Basic cost avoidance would result in massive growth in a number of publishers and marketers that participate in co-mailing, and a substantial improvement in the end-to-end efficiency of the flats mailstream overall.

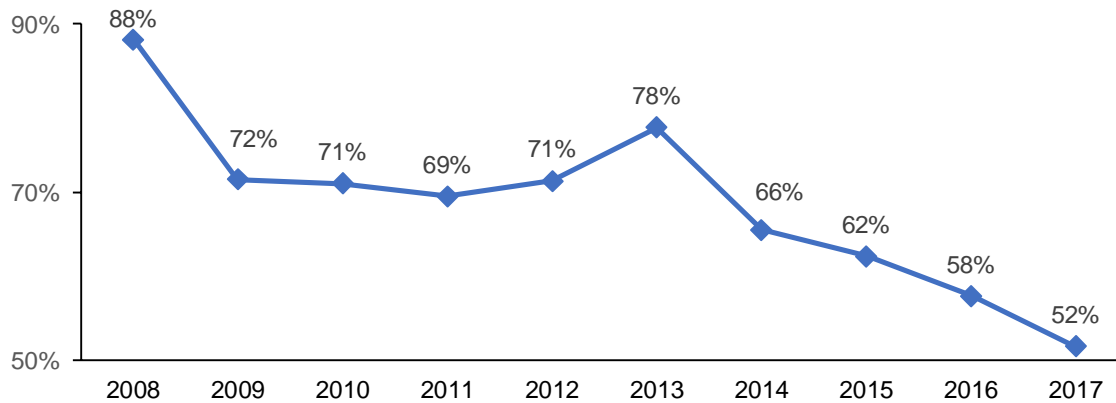
Quad/Graphics Decl. (Ma. 20, 2017) at 3.

The Commission, while chiding the Postal Service for refusing to give efficient price signals for Carrier Route preparation, has failed to enforce its words with adequate action. “For several years, and again in this docket, the Commission has highlighted the growing disparity between the pricing signals the Postal Service sends mailers that encourage 5-Digit presortation and discourage Carrier Route presortation.”⁵⁸

The Postal Service nonetheless has consistently reduced the Carrier Route passthrough, from 88 percent in FY 2007 to just 52 percent in FY 2017. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 7”, cells C7 and L7, respectively.

⁵⁸ Annual Compliance Determination Report, Fiscal Year 2014, at 16.

**Figure 14. Periodicals Outside County
Carrier Route Basic Passthroughs**



Source: Library Reference ANM *et al.*--LR--RM2017-3/4, “Figure 14.”

In ACR2017, the Commission went so far as to require the Postal Service to file a report on the issue. In the Update to Periodicals Pricing Report filed in Docket No. ACR2017 (USPS-FY17-44), the Postal Service tried to quantify the minor changes in mail preparation that have occurred in the last year in response to changes in classification and rate design. The report merely confirms how dysfunctional the current discount structure remains. As the Quad/Graphics Declaration in Phase 1 showed, the increases in efficiency that would result from providing an efficient (full) Carrier Route discount would be substantial, as this discount is the key discount for encouraging co-mailing. Put differently, the Postal Service’s current practice of setting the Carrier Route discount well below the corresponding cost avoided has resulted in substantial inefficiencies, regardless of the minor changes in mail preparation discussed in USPS-FY17-44.

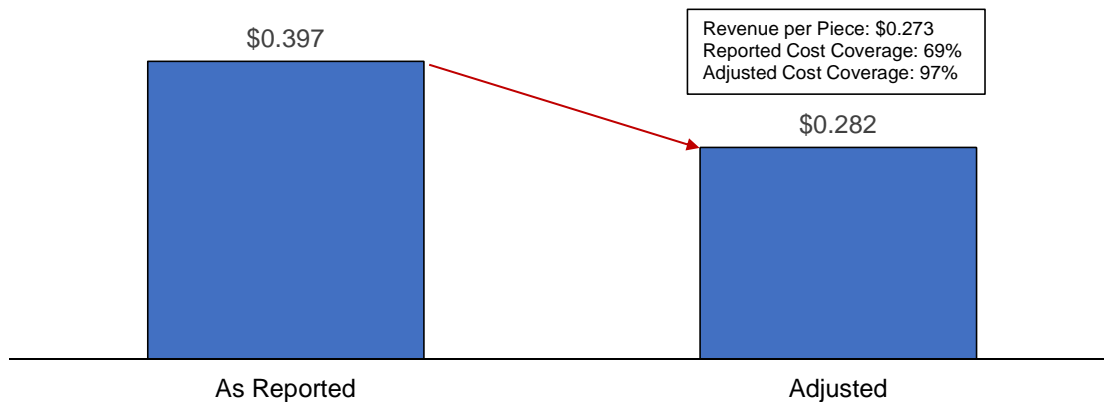
In Order No. 4258, the Commission has finally proposed to require the Postal Service to deepen worksharing discounts to some extent. At 87–98;

proposed 39 C.F.R. §§ 3010.260 through 3010.262. But the proposal, although welcome, is only the first step toward improving efficiency, and would not prevent the surcharges or offset their devastating effects. The Postal Service would enjoy a three-year “grace period” before the rule change would become binding, and the minimum required passthroughs for Periodicals Mail at the end of the grace period would still be only 75 percent, not 100 percent. Proposed 39 C.F.R. §§ 3010.261(b), 3010.262(a). In contrast, the extra surcharges proposed in Order No. 4258 for “noncompensatory” flats would take effect immediately. It would be more appropriate to reverse this order: raise the minimum passthrough levels more quickly, and delay further price increases until the Postal Service has had an opportunity to realize the efficiencies these changes will bring. Indeed, once proper incentives for preparation and entry are in place, the issue of “noncompensatory” products may eventually resolve itself.

(3)

The Postal Service’s inefficient downsizing and poor investment and pricing decisions over the last decade are the primary reasons for the reported revenue shortfall. Had the Postal Service maintained the status quo over the last decade, Periodicals Outside County unit attributable costs would have been 28.2 cents, close to its 27.3-cent revenue per piece. Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Tables 3”, cells D16 and D15, respectively.

Figure 15. FY 2017 Periodicals Outside County Cost Per Piece



Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Table 3.”

The remaining minor shortfall (less than a penny per piece) between revenue and attributable costs would be swamped by the large positive contribution from the First-Class Mail and Marketing Mail that Periodicals Mail generates. This secondary volume in other classes includes acknowledgments, renewal notices, invoices, and solicitations that publishers send in support of their publications. The contribution of these First-Class and Standard mailings from this multiplier effect averages about 6.7 cents for every magazine mailed at Periodicals rates:

Table 3. Adjusted Periodicals Outside County Cost Coverage

	Revenue per Piece	Cost per Piece	Cost Coverage
Without Multiplier Effect	\$0.273	\$0.282	96.9%
With Multiplier Effect	\$0.340	\$0.282	120.6%

Source: Library Ref. ANM *et al.*-LR-RM2017-3/4, “Figure 15 & Table 3.”

(4)

The story for Marketing Mail Flats over the last decade is essentially the same:

- The decreased flats sorting productivity discussed above has increased FY 2017 Marketing Mail Flats attributable cost per piece by 8.1 cents. Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 4”, cell D26.
- Marketing Mail Flats transportation costs per pound increased by 63 percent from FY 2008 to FY 2015, over six times the rate of inflation, raising FY 2017 Marketing Mail Flats attributable cost per piece by 1.3 cents. Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 4”, cell D27.⁵⁹
- Unit carrier costs for Marketing Mail Flats increased by 29 percent from FY 2008 to FY 2015, almost three times the rate of inflation, raising the FY 2017 Marketing Mail Flats attributable cost per piece by 2.8 cents. Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 4”, cell D28.

As shown in Table 4, adjusting for these factors, the FY 2017 unit cost for Marketing Mail Flats declines from 52 cents to 39.8 cents and its cost coverage increases from 74 percent to 97 percent.

⁵⁹ FY 2008 is the first year for which Marketing Mail Flats cost data are available in the Cost and Revenue Analysis. Excluding FY 2016 and FY 2017 avoids cost effects related to the rate design treatment of FSS mail.

Table 4. Adjusted Marketing Mail Flats Cost Coverage

	Revenue per Piece	Cost per Piece	Cost Coverage
As Reported	\$0.384	\$0.520	73.8%
Adjusted	\$0.384	\$0.398	96.6%

Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 4”

(5)

In Order No. 4257, the Commission speculates that the reductions in flat and bundle sorting productivity could possibly be due to (1) lost scale economies resulting from volume declines; or (2) a lack of capital investment. Order No. 4257 at 216. This speculation is unsupported.

With regard to volume declines, Commission-approved costing methods assume that mail processing workhours are essentially fully volume-variable. If this assumption is valid, volume declines should not hurt productivity. If the assumption is incorrect, then the mail processing costs attributed to Periodicals Outside County and other classes of mail are greatly overstated and should be reduced accordingly. The Commission cannot have it both ways.

The facts also refute the notion that the productivity declines have resulted from insufficient funds for capital investment. The Postal Service can maintain its flats sorting equipment if it uses its funds prudently. The Postal Service generated \$3.8 billion in cash from operations in Fiscal Year 2017 and ended the year with \$10.8 billion in cash. USPS Form 10-K, FY 2017, at 48. It would be irrational for the Postal Service to not make productive investments, if necessary, to prevent declines in flats sorting productivity. The real problem is that the Postal Service’s main investment in flats sorting

equipment over the last decade, the FSS, has increased costs, not reduced them. *See* pp. 87-94, *supra*.

B. The Commission has failed to reconcile the proposed surcharges for “noncompensatory” products and classes with Objective 1 and other provisions of PAEA.

The above facts make clear that the proposed extra surcharges for “noncompensatory” flats would violate multiple provisions of the PAEA. We have discussed all of the relevant objectives of 39 U.S.C. § 3622(b) and the CPI cap mandated by Section 3622(b)(1) and (2) in previous sections of these comments. The following discussion focuses in more detail on Objective 1 (maximizing incentives to reduce costs and increase efficiency). The proposed surcharges for “noncompensatory” flats mail would violate Objective 1 by rewarding the Postal Service with extra revenue for its own poor performance. Far from “maximize[ing] incentives to reduce costs and increase efficiency,” the surcharges would do the opposite.

The seriousness of this violation is compounded by the Commission’s refusal to take it seriously. The undersigned parties discussed the Postal Service’s mismanagement of flats mail at length in Phase 1.⁶⁰ In Order Nos. 4257 and 4258, however, the Commission has ignored the issue. In Order No. 4257, the Commission’s discussion of the flats coverage issue consists almost entirely of disparaging remarks about the “inhibiting” effect of the class-level price cap on the Postal Service’s ability to “ensure that each class or

⁶⁰ ANM *et al.* March 2017 Comments at 11–12, 54–57, and supporting Declarations of Rita Cohen, Jerry Faust, Michael Nadol (at 11), Michael Plunkett, Quad/Graphics, and Halstein Stralberg.

type of mail covers its attributable costs,” achieve allocative efficiency, and avoid unreasonably low rates and a net drain on the Postal Service’s finances. At 129, 133, 142, 227, 232–25, 274. The Commission’s discussion of Marketing Mail Flats is similar. *Id.* at 129, 140–42, 233–36, 274.

The Commission’s sole nod to the possibility that the Postal Service’s losses on flats might result from its own management decisions is a brief citation to a few of the mailer comments making this point, *id.* at 133 (2nd ¶), and an equally brief summary of some past Commission statements chiding the Postal Service for not doing more to study and control flats costs, *id.* at 203. These two points receive no further mention in the order, however. The Commission does not pause to explain why it has chosen to disregard the cited mailer comments, or why the Postal Service’s admitted failure to process flats efficiently should be irrelevant under Objectives 1 or 8. Instead, the Commission, once again blaming “the system,” sails undisturbed to the conclusion: “Non-compensatory products and classes further threatened the financial integrity of the Postal Service, as the system did not generate reasonable rates.” *Id.* at 274.

Order No. 4258 is equally blinkered. It denounces noncompensatory products and classes at length. At 73–81 (noncompensatory products other than Periodicals Mail), 81–87 (Periodicals Mail). By contrast, the mailers’ contention that “the ‘underwater’ condition of the [Periodicals] class is a function of excess costs, not overly-constrained prices” is relegated to a single parenthetical quotation, which the Commission then proceeds to ignore. *Id.* at 84. Mailers of flats should be grateful, the Commission concludes, because

it is not proposing to eliminate the CPI cap outright or make the Postal Service close the entire coverage gap immediately. *Id.* at 85–86.

The Commission’s brushoff of flats mailers’ concerns is particularly baffling in light of the Commission’s findings in its recent Annual Compliance Determinations and Docket No. RM2018-1. As discussed above, the Annual Compliance Determinations document problematic trends in the Postal Service’s costs and service performance for flats generally and Periodicals in particular. ACD for Fiscal Year 2014, at 16; ACD for Fiscal Year 2015 at 168–79; ACD for Fiscal Year 2016 at 165–66, 168; *see also Periodicals Mail Study*, Joint Report of the USPS and PRC (Sept. 2011).

Likewise, the Commission’s stated reason for beginning Docket No. RM2018-1, *Data Enhancements and Reporting Requirements for Flats*, less than five months ago was to “lead to the development of measurable goals to decrease the costs and improve the service performance of flats.” Order No. 4142 in Docket No. RM2018-1 (Oct. 4, 2017), at 5. The issues identified by the Commission for study in RM2018-1 have inflated Periodicals Outside County unit costs by 11.5 cents per piece and Marketing Mail Flats unit costs by over 12 cents per piece, and are the main cause of the failure of Periodicals Outside County and Marketing Mail Flats revenues to cover their costs:

Table 5. Adjustments to Periodicals Outside County and Marketing Mail Flats Costs

	Periodicals Outside County	Marketing Mail Flats
Reported Unit Cost	\$0.397	\$0.520
FSS Adjustment	- \$0.028	N/A ⁶¹
Mail Processing Adjustment	- \$0.052	- \$0.081
Transportation Adjustment	- \$0.014	- \$0.013
Carrier Adjustment	- \$0.021	- \$0.028
Adjusted Unit Cost	\$0.282	\$0.398

Source: Library Reference ANM *et al.*-LR-RM2017-3/4, “Table 5”

Docket No. RM2018-1 is still ongoing. In Order Nos. 4257 and 4258, however, the concerns expressed by the Commission about flats mail in the Annual Compliance Determinations and Docket No. RM2018-1 have vanished without a trace.

The one-sided nature of the Commission’s “noncompensatory” surcharge proposal is underscored by comparing it with the surcharges proposed in the 21st Century Postal Service Act of 2012 (S. 1789) and the Postal Reform Act of 2013 (H.R. 2748), the bills that may have been a model for the proposal in Order No. 4258. The 2012 and 2013 bills limited the proposed surcharges by including safeguards designed to avoid penalizing mailers of

⁶¹ As discussed above, the FSS Adjustment adjusts for the added cost of flats shifting from Carrier Route to FSS preparation. This increases the cost of all flat-shaped Marketing Mail, including flats in the Carrier Route product. It, however, does not affect the cost of the Marketing Mail Flats product, which does not include Carrier Route flats.

noncompensatory mail for losses resulting from Postal Service excess capacity or similar inefficiencies.

Section 402 of S. 1789, the 21st Century Postal Service Act of 2012, would have authorized an annual surcharge of two percent above the CPI for any class of mail that “bears less than 90 percent of the costs attributable to the class of mail.” But the bill would have required the Commission to adjust the attributable costs used in the adjustment “to account for the quantitative effect of excess mail processing, transportation, or delivery capacity of the Postal Service on the costs attributable to the class of mail.” S.1789 § 402. The bill also called for the Commission to “maximiz[e] incentives to reduce costs and increase efficiency with regard to the processing, transportation, and delivery of such mail by the Postal Service.” *Id.* The legislation passed the Senate on April 25, 2012, but was not taken up by the House.

H.R. 2748 would have required the Commission to determine the effects of excess capacity on the attributable cost of money-losing classes of mail *before* allowing the Postal Service any supplemental rate adjustment authority:

Within 90 days after the end of the first fiscal year beginning after the date of enactment of the Postal Reform Act of 2013, the Postal Regulatory Commission shall complete a study to determine the quantitative impact of the Postal Service’s excess capacity on the direct and indirect postal costs attributable to any class that bears less than 100 percent of its costs attributable . . . , according to the most recent annual determination of the Postal Regulatory Commission.

H.R. 2748 at 82-83.

Furthermore, H.R. 2748 would have authorized the Postal Service to raise the rates on noncompensatory classes of mail faster than the CPI only to

the extent that the revenue generated was less than *90 percent* of adjusted attributable cost, a threshold clearly met by Periodicals:

Unused rate authority shall be annually increased by 2 percentage points for each class of mail that bears less than 90 percent of its costs attributable . . . adjusted to account for the quantitative effect of excess capacity on the costs attributable of the class.

H.R. 2748 at 84-85.

While the surcharges proposed in Order No. 4258 for “noncompensatory” flats resemble the surcharge proposed in the 2012 and 2013 bills, the Commission has stripped out the conditions that the legislation would have required to be met before the surcharges could be applied. This is a crucial omission. As noted above, the cost coverage for Periodicals Mail and Marketing Mail Flats, when adjusted for excess capacity, is close to 100 percent. This would have avoided the surcharges under the proposed legislation. *See pp. 97-101.*

The Commission’s dismissive treatment of the efficiency issues that flats mailers and the Commission itself have raised is the antithesis of reasoned decision-making. An agency decision must be overturned as arbitrary and capricious if the agency has “entirely failed to consider an important aspect of the problem,” or “fail[ed] to respond meaningfully’ to objections raised by a party.”⁶² Reasoned decision-making requires that the Commission provide an

⁶² *See Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *AEP Tex. N. Co. v. STB*, 609 F.3d 432, 441–44 (D.C. Cir. 2010); *Cape Cod Hosp. v. Sebelius*, 630 F.3d 203, 216 (D.C. Cir. 2011); *LePage’s 2000, Inc. v. PRC*, 642 F.3d 225, 230–31, 234 (D.C. Cir. 2011); *GameFly, Inc. v. PRC*, 704

appropriate adjustment for excess capacity and related problems before considering surcharges of the kind proposed in Order No. 4258. Certainly, no surcharge for noncompensatory classes should be considered until the Postal Service: (1) ends the failed FSS experiment by removing these machines from all facilities; (2) returns flat sorting productivities and real unit transportation and carrier costs to 2007 levels; and (3) promotes efficient preparation by passing through 100 percent of Carrier Route Basic cost avoidance.

C. Despite the Postal Service's needlessly high costs, Periodicals Outside County Carrier Route mail already covers its attributable costs.

Even if (contrary to fact) Objective 5 could justify the Commission's proposal to impose extra surcharges on mail found to be noncompensatory, the proposed surcharges would be overbroad. Even without adjustment for the needless extra costs caused by the Postal Service's insufficient downsizing, the revenue from typical Periodicals Outside County Carrier Route mailings covers reported attributable costs today.⁶³ As Halstein Stralberg explained in his declaration for the undersigned parties in Phase 1 of this docket, the cost coverage for the most common Periodicals Outside County Carrier Route preparation—DSCF-entered Carrier Route flats entered on 3-Digit/SCF pallets—was approximately 100 percent in Fiscal Year 2016 despite the dismal

F.3d 145, 148–49 (D.C. Cir. 2013); *BNSF Ry. Co. v. STB*, 741 F.3d 163, 168 (D.C. Cir. 2014).

⁶³ Similarly, the Marketing Mail Carrier Route product covers its cost and the Commission does not propose applying a noncompensatory surcharge to it.

trends in the Postal Service’s efficiency in handling Periodicals Outside County over the last decade. Stralberg Decl. (Mar. 20, 2017) at 14–16.⁶⁴

This remained true in Fiscal Year 2017. Moreover, adjusting the attributable cost data to reflect the effect of the Postal Service’s insufficient downsizing efforts on Periodicals costs and the multiplier effect, the contribution of Carrier Route mailings exceeds 12 cents per piece:

Table 6. Reported and Adjusted Periodicals Outside County Carrier Route Cost Coverage

	Revenue per Piece	Cost per Piece	Cost Coverage
Unadjusted	\$0.230	\$0.221	104.3%
Without Multiplier Effect	\$0.230	\$0.175	131.7%
With Multiplier Effect	\$0.297	\$0.175	169.9%

Source: Library Reference ANM *et al.*--LR--RM2017-3/4, “Table 6.”

CONCLUSION

We recognize that these comments are highly critical of the Commission’s approach in this docket. That does not mean, however, that we are unaware of the challenges facing the Postal Service, or believe that the Commission cannot help the Postal Service meet them. But the Commission’s proposals—in addition to being barred by the statute—misdiagnose the problems and will only exacerbate the Postal Service’s financial difficulties. The Postal Service needs more incentive to reduce costs and increase efficiency,

⁶⁴ Typical Carrier Route mailings are entered at the DSCF on 3-Digit/SCF pallets. *Id.* at 14 – unclear what this refers to.

not less. The Commission should focus on how much money the Postal Service needs to meet its present and likely future obligations to its retirees, not how much money would be required in the (counterfactual) assumption that the Postal Service could somehow catch up with the absurd prefunding schedule that PAEA purported to impose, but Congress has not enforced since then. No amount of rate relief from the Commission can provide it with the revenue necessary to meet the latter obligations, which are wholly divorced from the market conditions facing the Postal Service. And ratepayers need continued protection from abuse of the Postal Service's monopoly power. The Commission's proposals do not meet any of these needs.

The Commission's best option going forward is to withdraw the proposed rules and reexamine both the problems facing the Postal Service and the Commission's options for helping the Postal Service develop solutions to those problems. Even if the Commission concludes that the Postal Service requires additional revenue, it must, at a minimum, more carefully analyze the additional revenue necessary and the potential effect on volumes that attempts to provide that revenue would cause.

A comprehensive rewrite of the system of ratemaking requires more deliberation and analysis than the Commission has engaged in to date, and a greater opportunity for comment than the Commission has allowed. While the Commission took almost 9 months to review the current system of ratemaking and develop its proposed revisions, it has provided little opportunity for public comment in this process. It engaged in its review after issuing an Advanced Notice of Proposed Rulemaking that offered only a cursory outline of the

standards that the Commission intended to apply, then applied different standards than noticed in its review. At times in Order No. 4257, the Commission relied on information provided by the Postal Service in response to the ANOPR but, because the Commission did not allow reply comments, it lacked the benefit of other information that could have placed the information from the Postal Service in context or countered the Postal Service's narrative. The Commission then issued both its findings on the current system and its proposed revision at the same time, and provided only 90 days for the public to digest and respond to the over 500 pages of information contained in these orders, much of which could not have been predicted from the ANOPR.

The results of this process so far have been logically and factually flawed conclusions about the current system and proposed solutions that are illegal, unsupported by evidence, and dismissive of a century of regulatory economic theory. The Commission must do better. The mailing industry is willing to work with the Commission and the Postal Service to develop viable solutions, but it must be given a real opportunity to do so. At a minimum, if the Commission determines after the current round of comments that it must still make revisions to the system of ratemaking, it should issue a revised NOPR responding to the comments to date, proposing rules that properly balance the objectives of PAEA while remaining within the bounds of the Commission's authority. Better yet, the Commission should convene technical conferences and public hearings to allow the collaborative, deliberate development of potential alternatives before issuing new proposed rules. Such a process may moderate stakeholder positions in ways that the current process cannot.

Providing only two rounds of comments on a proposal that radically departs from the existing system, with everything at stake for the industry, forces stakeholders to protect their interests by taking more adversarial positions.

In the end, the Postal Service's problems are not intractable. Solutions exist. These proposed rules, however, are not among them.

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Appendix A

LIMITATIONS ON THE COMMISSION'S AUTHORITY UNDER SECTION 3622(d)(3)

WHITE PAPER SUBMITTED TO THE POSTAL REGULATORY COMMISSION BY ALLIANCE OF NONPROFIT MAILERS, ASSOCIATION FOR POSTAL COMMERCE, ASSOCIATION OF MARKETING SERVICE PROVIDERS, DIRECT MARKETING ASSOCIATION, EMA, MPA—THE ASSOCIATION OF MAGAZINE MEDIA, NATIONAL ASSOCIATION OF ADVERTISING DISTRIBUTORS, INC., AND SATURATION MAILERS COALITION

October 28, 2014

LIMITATIONS ON THE COMMISSION'S AUTHORITY UNDER SECTION 3622(D)(3)**PREPARED FOR THE POSTAL REGULATORY COMMISSION**

39 U.S.C. § 3622(d)(3) directs the Postal Regulatory Commission (“PRC” or “Commission”), ten years after the enactment of the Postal Accountability and Enhancement Act (“PAEA”), Pub. L. 109-435, 120 Stat. 3198 (2006), to “review the system for regulating rates and classes for market-dominant products established under this section.” This White Paper considers whether the Commission’s authority under Section 3622(d)(3) includes the power to rescind or substantially modify the Consumer Price Index (“CPI”) cap established under Section 3622(a) and (d). For the reasons explained here, the answer is no.

EXECUTIVE SUMMARY

In recent months, it has been suggested that the Commission could use the ten-year review to eliminate or substantially modify the CPI-based cap on class-average revenue per piece imposed by 39 U.S.C. §§ 3622(d)(1) and (2). The argument runs as follows: Section 3622(d)(3) provides that the Commission’s ten-year review shall include a determination of whether the “system for regulating rates and classes for market-dominant products established under this section” is achieving the “objectives” of Section 3622(b), “taking into account the factors of” Section 3622(c). If the Commission finds that the “system” is not achieving the Section 3622(b) “objectives” in light of the Section 3622(c) “factors,” the Commission “may, by regulation, make such modifications or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.” *Id.* § 3622(d)(3). The CPI cap is part of the regulatory system for market-dominant products. So, the theory goes, the Commission, on finding that the CPI cap is not achieving the “objectives” of Section 3622(b), may eliminate the

cap and replace it with some other regulatory “system” or substantially relax the manner in which the cap now operates. This theory fails on two independent grounds:

(1)

The argument is an impermissible construction of the statutory language. Section 3622(d) defines the CPI cap as a binding and mandatory “requirement,” not just a discretionary “objective” or “factor.” *Id.* § 3622(d)(1). The Commission may not interpret as permissive a statutory provision that is so plainly mandatory. Further, inferring such authority from Section 3622(d)(3) would stretch the “review” of the regulatory scheme far beyond the bounds allowed by the language of Section 3622(d)(3) and Supreme Court precedent such as *MCI Telecomm. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 231 (1994).

Moreover, eliminating the CPI cap would contravene the *overall* structure and purpose of PAEA and, in particular, the relationship between Section 3622(d)(3) and Section 3622(a). The “system” that Section 3622(d)(3) directs the Commission to review and possibly modify after ten years is the same “system” that Section 3622(a) directed the Commission to create. The statute requires that both Commission actions be based on the same “objectives” and “factors” enumerated in Sections 3622(b) and (c). The Commission has repeatedly acknowledged that those “objectives” and “factors,” and the “system” of regulation that Congress directed the Commission to build on them, are all subordinate to the “quantitative pricing standards” of PAEA, including the CPI cap. The role of the CPI cap in the statutory hierarchy is absolute, “central,” and “indispensable”; the Commission’s role in “establishing” the “system for regulating rates and classes” is secondary and interstitial. Docket No. R2010-4, *Rate Adjustment Due to Extraordinary*

or Exceptional Circumstances, Order No. 547 (Sept. 30, 2010) at 10–13, 49–50 [hereinafter Order No. 547]; *accord* Docket No. RM2009-3, *Consideration of Workshare Discount Rate Design*, Order No. 536 (Sept. 14, 2010) at 16–17, 35–36 [hereinafter Order No. 536]; *USPS v. PRC*, 676 F.3d 1105, 1108 (D.C. Cir. 2012), *on remand*, Order No. 1427 at 17–19. Nothing in the text, structure, or legislative history of PAEA suggests that the Commission’s authority to review, modify, or replace the “system” of regulation under Section 3622(d)(3) is broader than the Commission’s authority to “establish” the “system” of regulation under Section 3622(a).

(2)

The proposed reading of Section 3622(d)(3) would raise constitutional issues. A fundamental canon of statutory construction bars agencies from construing a statute in a way that even raises serious doubts about its constitutionality. Construing Section 3622(d)(3) to authorize the Commission to eliminate the CPI cap would do just that. In *Clinton v. State of New York*, 524 U.S. 417, 438–99 (1998), the Supreme Court held that the Presentment Clause of the Constitution, U.S. Const., Art. I, § 7, cl. 2, bars Congress from delegating to the executive branch the authority to amend or repeal statutes. In addition, wholesale repeal or modification of the CPI Cap would implicate the Constitutional limitations on the power of Congress to delegate its legislative function to administrative agencies under cases such as *Panama Ref. Co. v. Ryan*, 293 U.S. 388 (1935) and *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

* * *

In sum, PAEA established a system of rate regulation whereby the Postal Service cannot raise rates by more than CPI, as applied at the class level, absent extraordinary or exceptional

circumstances. The Commission is not empowered to subvert the judgment of Congress by replacing this constraint with an alternative method of regulating rates.

ANALYSIS

I. PAEA ESTABLISHED THE CPI CAP AS A BINDING CONSTRAINT THAT THE COMMISSION MAY NOT REPEAL OR SUBSTANTIALLY MODIFY.

The text, structure, purpose, and legislative history of Section 3622 make clear that that the CPI cap mandated by Section 3622(a) and (d) is a fixed and binding constraint that the Commission has no authority to repeal or substantially loosen under Section 3622(d)(3).

A. The Binding Character of the Price Cap Is the Linchpin of the Statute.

As always, the first step in divining the meaning of a statute is “the language of the statute itself.” *Caraco Pharm. Labs v. Novo Nordisk*, 132 S. Ct. 1670, 1680 (2012); *CSX Transp., Inc. v. Alabama Dept. of Rev.*, 131 S. Ct. 1101, 1107 (2011). The plain language of Section 3622 establishes the CPI cap as the primary requirement of any system of rate regulation developed by the Commission and prevents the Commission from eliminating that requirement during its 10-year review of the system. PAEA § 401, codified at 39 U.S.C. § 3622(d)(1)(A), prescribes the CPI cap in mandatory terms (“requirements” and “shall”):

Requirements.--

(1) In general.--The system for regulating rates and classes for market-dominant products ***shall***--

(A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal

variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;

39 U.S.C. § 3622(d)(1)(A) (emphasis added).

The CPI cap limits the annual increase in average revenue per piece on any market-dominant class of mail to the rate of inflation. Section 3622(d) provides two exceptions to the CPI cap: exigent circumstances (§ 3622(d)(1)(E)) and the use of prior rate increase authority that has been banked (§ 3622(d)(2)(C)). Beyond these two exceptions, this CPI cap is absolute. Order No. 536 at 16, 35–36; *USPS v. PRC*, 676 F.3d 1105, 1108 (D.C. Cir. 2012), *on remand*, Order No. 1427 (Aug. 9, 2012) at 17–19. As noted above, Section 3622(d), in contrast to Section 3622(b) (“Objectives”) and Section 3622(c) (“Factors”), is entitled “Requirements.”

Other provisions of Section 3622,—e.g., the rounding provision,¹—flesh out how the price cap shall be implemented. The provisions that leave the PRC some discretion—e.g., Section 3622(d)(1)(C), which directs the Commission to develop procedures for reviewing non-compliance with the CPI rate cap—concern interstitial details and enforcement procedures.

The CPI cap is the linchpin of PAEA. In the Commission’s own words, the role of the CPI cap in the statutory hierarchy is absolute, “central” and “indispensable.” Order No. 547 at 10–13, 49–50; *accord* Order No. 536 at 16–17, 35–36. Through PAEA, Congress sought to create a profit

¹ 39 U.S.C. § 3622(d)(2)(B) (“Nothing in this subsection shall preclude the Postal Service from rounding rates and fees to the nearest whole integer, if the effect of such rounding does not cause the overall rate increase for any class to exceed the Consumer Price Index for All Urban Consumers.”).

motive for the Postal Service and improve efficiencies in the postal networks by eliminating the break-even mandate.² To replace the break-even mandate as the main safeguard for users of market-dominant mail products, Congress required the adoption of a price cap linked to the rate of inflation. Order No. 547 at 10–12. “PAEA removed any reference to cost-of-service regulation, establishing the price cap as the *only regulatory model to be used under the new rate system.*” *Id.* at 10 (emphasis added). “The broad flexibility” in pricing otherwise allowed the Postal Service by PAEA “underscores the importance of the price cap as a protection mechanism for ratepayers.” *Id.* at 12. “The price cap . . . stands as the single most important safeguard for mailers.” *Id.* at 13. The “role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the incentive to reduce costs is to remain effective. Therefore, it would undermine the basic regulatory approach of the PAEA if the Postal Service could pierce the price cap routinely.” *Id.* at 49–50.

The mandatory language used by Congress in establishing the CPI cap (the Commission “shall” establish a regulatory system, including the “requirement” of the CPI cap) and the central role of the CPI cap in the PAEA ratemaking scheme foreclose any claim that the statute makes the CPI cap merely optional. “The word ‘shall’ is ordinarily ‘the language of command.’” *Alabama v. Bozeman*, 533 U.S. 146, 153 (2001) (citations omitted); *see also Lopez v. Davis*, 531 U.S. 230, 231 (2001) (“Congress used ‘shall’ to impose discretionless obligations”). Although the courts sometimes treat “shall” as permissive when treating the word as mandatory would produce results

² See Gov’t Accountability Office, GAO-07-684T, U.S. Postal Service: Postal Reform Law Provides Opportunities to Address Postal Challenges 1, 17–19 (2007), *available at* <http://www.gao.gov/assets/120/116185.pdf>.

that are “inconsistent with the manifest intent of the legislature or repugnant to the context of the statute,” *Kakeh v. United Planning Org., Inc.* 655 F. Supp. 2d 107, 124–25 (D.D.C. 2009), the plain meaning and purpose of the language mandating the CPI cap are aligned: the binding character of the cap is the linchpin of the statute.

B. Section 3622(d)(3) Directs the Commission to Review the Ratemaking System that It Established in 2007, not Repeal or Modify the CPI Cap Established by Congress.

By contrast, nothing in 39 U.S.C. § 3622(d)(3) suggests its directive to review and modify the “system for regulating rates and classes” previously adopted by the Commission under Section 3622(a) includes the power to repeal the *statutory price cap itself*. To the contrary, *MCI Telecomm. Corp. v. Am. Tel. & Tel. Co.* forecloses such a construction. In *MCI*, the Federal Communications Commission (“FCC”) held that its statutory authority to “modify” rate-filing requirements entitled the agency to eliminate tariff-filing requirements for some telecommunications services. *Id.* at 224–25. The Supreme Court rejected this position, holding that the power to “modify” did not permit the agency to make major changes to a regime established by Congress under basic rules of statutory construction. *Id.* at 234. More broadly, the Supreme Court stated that “[i]t is highly unlikely that Congress would leave the determination of whether an industry will be entirely, or even substantially, rate-regulated to agency discretion—and even more unlikely that it would achieve that through such a subtle device as permission to “modify” rate-filing requirements.” *Id.* at 231.³

³ The dissenting justices in *MCI* would have allowed the agency to “modify” the Communications Act’s tariff filing requirement because in their view, the provision, while important, was not “the

MCI makes clear that substantive provisions “at the heart” of the statute may not be amended through modifications. Because the provisions of Section 3622 establishing the CPI cap are “at the heart” of price regulation of market dominant mail under PAEA, the Commission cannot effectively introduce “a whole new regime of regulation” that is “not the one that Congress established.” See *MCI*, 512 U.S. at 234. A statutory provision calling for the review of a regulatory system cannot reasonably be interpreted as a basis for a complete overhaul of the fundamental principles of the system. Such an interpretation would take Section 3622(d)(3) far beyond “plausibility.” Accord *Christensen v. Harris Cnty.*, 529 U.S. 576, 590 n.* (2000) (Scalia, J., concurring in part and concurring in judgment) (noting “the implausibility of Congress’s leaving a highly significant issue unaddressed (and thus ‘delegating’ its resolution to the administering agency)”). The Commission can, and indeed must, evaluate and modify the regulatory scheme set up in response to PAEA—but the modifications or alternative systems are bound by CPI cap established in Section 3622(d)(1)(A).

heart of the common-carrier section of the Communication Act.” *Id.* at 237 (Stevens, Blackmun, and Souter, JJ., dissenting). As noted above, the PRC has acknowledged that the price cap provision is in fact the central feature of PAEA. Hence, Section 3622(d)(3) could not be interpreted to allow the modification of the CPI cap even under the reasoning of the dissent. *National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 418 (1992) (“*Amtrak*”), distinguished by Justice Scalia, is also inapposite. The “contextual context” of the term “required” at issue in that case involved a determination of whether the agency action at issue was “necessary” or merely useful; under PAEA, by contrast, the PRC is “required” to review the regulatory system, but the contextual context makes clear that the PRC cannot modify or repeal the price cap.

Moreover, as the Supreme Court has pointed out, “Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouse holes.” *Whitman v. Am. Trucking Assn’s*, 531 U.S. 457, 468 (2001). Nothing in the language of Section 3622(d)(3) specifically authorizes the PRC to modify the CPI cap; indeed, Section 3622(d)(3) does not even refer to the cap requirements. Congress may not be deemed to have authorized elimination of the price cap—“the single most important safeguard for mailers” in PAEA⁴—by omission or indirection. Section 3622(d)(3) may not be read as allowing the Commission to remove this fundamental protection during the 10 year review without express and explicit authorization in the statutory text.

Pursuant to the authority granted by 39 USC § 3622(d)(3), the Commission is free to modify its regulations or adopt alternative regulations to meet the objectives of Section 3622(b) if the PRC determines that the existing system of regulation is not doing so; however, the regulatory scheme must still meet the basic requirements contained in Section 3622(d)(1). Thus, any modified system for regulating rates would be subject to the CPI cap, absent congressional amendment. “[T]he power to issue regulations is not the power to change the law.” *U. S. v. New England Coal & Coke Co.*, 318 F.2d 138, 143 (1st Cir. 1963).

C. The Relationship Between Section 3622(a) and Section 3622(d)(3) Confirms that the Commission’s Authority to Revise the Ratemaking System Does Not Extend to the CPI Cap.

In construing the statute, the Commission may not interpret its provisions in isolation, but must consider each one in light of the overall “structure and purpose of the statute. The

⁴ Order No. 547 at 13.

Commission itself has recognized that PAEA, like all statutes, must be interpreted as a coherent and symmetrical regulatory scheme and, if possible, all parts must be fitted into a harmonious whole.” Order No. 547 at 25 (citing *Chemehuevi Tribe of Indians v. FPC*, 420 U.S. 395 (1975); *Cody v. Cox*, 509 F.3d 606, 609 (D.C. Cir. 2007)), *remanded on other grounds*, *USPS v. PRC*, 640 F.3d 1263 (D.C. Cir. 2011); *accord K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988). “The meaning of words should be determined by specific context in which they are used and within the broader context of the statute as a whole.” Order No. 547 at 25 (citing *Russello v. United States*, 464 U.S. 16, 23 (1983); *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997); *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132–33 (2000)). The overall structure of PAEA provides further confirmation that Section 3622(d)(3) does not authorize the Commission to rescind or substantially modify the CPI cap.

Section 3622(d)(3), which authorizes the Commission to modify its “system for regulating rates and classes for market-dominant products,” mirrors Section 3622(a), which authorized the Commission to “establish” the “system for regulating rates and classes for market-dominant mail” in the first instance. A word or phrase that appears in two or more provisions of the same Section of a statute is presumed to have the same meaning each time. *Mohasco Corp. v. Silver*, 447 U.S. 807 (1980). “[T]here is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning.” *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

This conclusion is reinforced by the explicit references in Section 3622(d)(3) to the “objectives” of Section 3622(b) and the “factors” of Section 3622(c) as the criteria to govern the ten-year review. These “objectives” and “factors” are the *same* “objectives” and “factors” that

Section 3622(b) and (c) directed the Commission to consider in 2007 when initially establishing a “system for regulating rates and classes” for market-dominant mail under Section 3622(a). Hence, the Commission’s authority to *modify* the “system for regulating rates and classes” under Section 3622(d)(3) must be regarded as coextensive with the Commission’s initial authority to *establish* the “system” under Section 3622(a):

Section 3622(a)	Section 3622(d)(3)
The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, by regulation establish (and may from time to time thereafter by regulation revise) a modern system for regulating rates and classes for market-dominant products.	Ten years after the date of enactment of the Postal Accountability and Enhancement Act and as appropriate thereafter, the Commission shall review the system for regulating rates and classes for market-dominant products established under this section to determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c). If the Commission determines, after notice and opportunity for public comment, that the system is not achieving the objectives in subsection (b), taking into account the factors in subsection (c), the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.
Section 3622(b)	
Objectives. — Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others: [list of objectives omitted]	
Section 3622(c)	
Factors. — In establishing or revising such system, the Postal Regulatory Commission shall take into account— [list of factors omitted]	

This parallelism precludes any claim that Section 3622(d)(3) authorizes the Commission to rescind or substantially modify the CPI cap. As the Commission has repeatedly acknowledged, the Commission’s role in establishing a “system of regulation” under Section 3622(a) was merely to fill in the gaps between the “quantitative pricing standards” established by Congress in Sections

3622(d)(1)(A), 3622(d)(2), 3622(e) and 3626. Nothing in the language, structure or history of PAEA suggests that it gave the Commission greater authority to override or repeal the CPI cap when *reviewing* or *modifying* the “system for regulating rates” under Section 3622(d)(3) than when initially *establishing* the same “system” under Section 3622(a). Accordingly, the Commission’s authority to *modify* the “system” under Section 3622(d)(3) must likewise be regarded as subordinate to the CPI cap.

At the top of the statutory hierarchy of PAEA are the three “quantitative pricing standards” that are hard-wired into Title 39: the CPI cap imposed by Section 3622(d)(1)(A) and (2); the limit on worksharing discounts imposed by Section 3622(e); and the constraints imposed by Section 3626 on the rate relationships between preferred mail and regular mail. The Commission has recognized that the “out-of-bounds” lines established by these three “objective, quantitative pricing standards” are “mandatory”:

Under the system that the Commission has established, the Postal Service enjoys a general prerogative to set market dominant rates, subject to only a few, clear “out-of-bounds” lines drawn by the PAEA. These “out-of-bounds” lines consist of pricing restrictions in three areas—the cap on class prices (*see* section 3622(d)), the limit on workshare discounts (*see* section 3622(e)), and revenue ceilings for the various categories of preferred mail (*see* section 3626). Congress framed each of these requirements as objective, quantitative pricing standards, made their application mandatory, and placed each in a self-contained section of the PAEA.

Order No. 536 at 16. These self-contained “quantitative” provisions “directly and comprehensively address issues of flexibility, including when deviations from the standard are warranted, and the procedures to be followed in such situations.” *Id.* at 34.

The “factors” and “objectives” of sections 3622(b) and (c)—and therefore the Commission’s authority to establish a “system for regulating rates” under Section 3622(a) or modify such a “system” under Section 3622(d)(3)—are subordinate to the CPI cap and the other quantitative pricing standards:

Quantitative pricing standards are at the top of the statutory hierarchy. Next in the hierarchy are the qualitative “objectives” listed in section 3622(b), followed by the qualitative “factors” listed in section 3622(c). Under this hierarchy, violations of the three quantitative pricing requirements are “out of bounds.” The Postal Service has broad flexibility to develop prices to achieve the qualitative objectives and factors of sections 3622(b) and (c) *so long as its prices are “in bounds” because they satisfy these quantitative requirements.*

Order No. 536 at 36 (emphasis added), *on further consideration*, Docket No. RM2010-13, *Consideration of Technical Methods to Be Applied in Workshare Rate Design*, Order No. 1320 (April 20, 2012), *aff’d*, *USPS v. PRC*, 717 F.3d 209 (D.C. Cir. 2013). “[U]nder accepted rules of statutory construction when a general, qualitative pricing standard . . . conflicts with a specific qualitative pricing standard, such as the limit on workshare discounts, the pricing standards that are specific and mandatory should prevail over those that are general and discretionary.” Order No. 536 at 37 (citations omitted); *accord id.* at 16–17.⁵

⁵ The objectives and factors of Sections 3622(b) and (c) are also subordinate to 39 U.S.C. §§ 403(c) and 3662(c), the statutory safeguards against undue discrimination. *USPS v. PRC*, 747 F.3d 906, 913 (D.C. Cir. 2014) (“*GameFly II*”) (the “system for regulating rates and classes” established by the Commission under Section 3622(a), and the objectives and factors of Sections 3622(b) and (c), do not govern the Commission’s exercise of its authority under Sections 403(c) and 3662(c)).

The Commission reaffirmed the subordinate and limited role of Sections 3622(b) and (c) in the Annual Compliance Determination (“ACD”) for Fiscal Year 2010. Rejecting the Public Representative’s contention in Docket No. ACR2010 that the attributable cost provision of 39 U.S.C. § 3622(c) stood on equal footing with the CPI-based price cap of Section 3622(d), the Commission held that the price cap trumps the attributable cost floor:

The Public Representative reasons that the statutory price cap and the attributable cost floor provision in section 3622(c)(2) are on equal footing. This is based on the contention that section 3622(c)(2) is a quantitative requirement, notwithstanding its location with the cluster of statutory factors the Commission identified, in Order No. 536, as qualitative

Section 3622 creates a hierarchy based on “requirements,” sections 3622(d) and (e), “objectives,” section 3622(b), and “factors,” section 3622(c). With the exception of an exigent rate request and use of banked pricing authority, the PAEA’s price cap mechanism in section 3622(d)(1)(A) takes precedence over the statutory pricing objectives and factors in sections 3622(b) and (c), even if some of these can be considered quantitative. Therefore, to the extent an objective or factor with a quantitative component can be seen as competing with the price cap, the price cap has primacy . . .

[T]he objectives and factors, including those that can be regarded as quantitative operate within the context of the price cap; they are not on an equal footing with it.

FY 2010 ACD (Mar. 29, 2011) at 18–19 (footnotes omitted).

On review of the 2010 ACD, the Court of Appeals agreed, finding that “the pricing” of Periodicals Mail “is subject to special statutory restrictions” inapplicable to the pricing of Standard Mail flats. *USPS v. PRC*, 676 F.3d 1105, 1108 (D.C. Cir. 2012). On remand, the Commission reiterated that it faced greater statutory constraints in raising prices for Periodicals mail than Standard Mail flats because the former constituted a class, and hence was subject to the CPI cap:

Moreover, the fact that Periodicals has only two products (Within County and Outside County Periodicals), neither of which covered its attributable costs, limits the opportunity for the Postal Service to improve attributable cost coverage by means of price increases while remaining within the Periodicals class price cap.

Docket No. ACR2010-R, *Annual Compliance Report, 2010*, Order No. 1427 (Aug. 9, 2012) at 17. Because “96 percent of class revenues are provided by Outside County Periodicals, the Postal Services does not have the same flexibility to set prices substantially above the price cap as it does with respect to products within Standard Mail.” *Id.* at 18 (citing FY2010 ACD at 94).

The Commission acknowledged this legal constraint again in its Annual Compliance Review for the Fiscal Year 2011, ACR2011. The Commission again declined to impose an above-CPI rate increase on Periodicals Mail despite finding that the class failed to cover its attributable costs. The Commission explained, *inter alia*, that “unlike Standard Mail, Periodicals as a class fails to cover costs, thus foreclosing a rebalancing pricing strategy.” FY 2011 Annual Compliance Determination (Mar. 28, 2012) at 17 (emphasis added).

Finally, interpreting the Commission’s general authority under Section 3622(d)(3) as a license to override or revoke the specific prescriptions of PAEA concerning the relationships between market-dominant price increases vs. inflation (Section 3622(d)(1)(A) and (B)), workshare discounts vs. cost avoidances (Section 3622(e)), and preferred rates vs. regular rates (Section 3626) would also violate the “fundamental rule of statutory construction” that, when two statutory provisions are arguably in conflict, “specific provisions trump general provisions.” *Navarro-Miranda v. Ashcroft*, 330 F.3d 672, 676 (5th Cir. 2003). This canon of construction applies with particular force where, as here, “Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.” *RadLAX Gateway Hotel, LLC*

v. Amalgamated Bank, 132 S. Ct. 2065, 2070–72 (2012) (citations omitted); *accord Morton v. Mancari*, 417 U.S. 535, 550–51 (1974); *Mail Order Ass’n of Am. v. USPS*, 986 F.2d 509, 515 (D.C. Cir. 1993).

D. The Legislative History of PAEA also Indicates that the CPI Cap Is Mandatory.

The legislative history of PAEA does not support a contrary conclusion. As a general matter, the legislative history of a statute is entitled to much less weight than the text and structure of the statute, particularly when the meaning of the latter is clear. “Congress’s ‘authoritative statement is the statutory text, not the legislative history.’” *Chamber of Commerce of the U.S. v. Whiting*, 131 S. Ct. 1968, 1980 (2011) (quoting *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005)). As discussed above, the text and structure of Section 3622 make clear that the CPI cap is binding and not open to rescission by the Commission. The legislative history of PAEA is not to the contrary.

The legislative history of PAEA is sparse and scattered across several bills, including H.R. 22 and S. 622, which eventually combined to form H.R. 6407. None of the legislative history speaks to the purpose or proper interpretation of the review provision of Section 3622(d)(3), which appears to have been added to H.R. 6407 without hearings, Committee consideration, or floor debate. *See Whitman*, 531 U.S. at 468 (denying an agency the ability to fundamentally revise a regulatory scheme based on “vague terms or ancillary provisions” because Congress does not “hide elephants in mouseholes”). By contrast, the only report regarding the CPI rate cap requirement stems from H.R. 22, and states that “[t]he legislation *would mandate* that the average rate for any market dominant product *could not* rise more than the annual increase in the Consumer Price Index

(CPI), unless a larger increase would be necessary to ensure the viability of the Postal Service.” H.R. Rep. No. 109-66, Part 1, at 86 (2005) (emphasis added). This intent is bolstered by the fact that the final version of PAEA in H.R. 6407 denoted Section 3622(d) “requirements” rather than “allowable provisions” as proposed in H.R. 22. The language and legislative history from earlier, *unenacted* bills shows that Congress contemplated giving the Commission more discretion regarding the rate cap, and was fully capable of drafting language to do so.

* * *

In sum, the text and structure of the statute demonstrate that the CPI cap is a non-discretionary requirement that the Commission may not remove through regulation. As the Postal Service’s Office of Inspector General has acknowledged, eliminating the CPI cap would require an act of Congress.⁶

II. CONSTRUING SECTION 3622(d)(3) TO AUTHORIZE THE COMMISSION TO ELIMINATE THE CPI CAP WOULD VIOLATE THE CONSTITUTIONAL-DOUBT CANON OF INTERPRETATION.

Interpreting Section 3622(d)(3) to authorize rescission of the CPI cap would also raise constitutional issues. The constitutional-doubt canon prohibits agencies from construing statutes in such a way as to raise serious doubts about their constitutionality. *United States v. Delaware & Hudson Co.*, 213 U.S. 366, 408 (1909); *Lowe v. SEC*, 472 U.S. 181, 227 (1985); *Edward J.*

⁶ See USPS OIG, Revisiting the CPI-Only Price Cap Formula, RARC-WP-13-007, at iv (Apr. 12, 2013) (noting that “[i]f Congress decides to continue using a price cap” the USPS would need to use “alternative approaches” to “improve its financial condition”).

DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988).

There is a serious doubt that construing Section 3622(d)(3) to authorize the Commission to rescind the CPI cap would pass muster under the Presentment Clause of the Constitution, U.S. Const. Art. 1, § 7, cl. 2, or the constitutional limits on the delegation of legislative authority.

Removal or substantial modification of the CPI cap would effectively repeal 39 U.S.C. §§ 3622(d)(1)(A), (D), (E) and 3622(d)(2), the provisions that established the creation of the CPI cap and continue to require its use as a constraint on market-dominant rates. The Presentment Clause, however, does not allow a bill to become law without first passing both houses of Congress and being “presented” to the President, who “shall sign it” if he approves it, but “return it,” *i.e.*, veto it, if he does not. U.S. Const., Art. 1, § 7, cl. 2. The Presentment Clause also bars Congress from delegating to the executive branch the authority to *amend* or *repeal* statutes. *Clinton*, 524 U.S. at 438–49.

In *Clinton*, the Supreme Court struck down as contrary to the Presentment Clause a provision of the Line Item Veto Act, 2 U.S.C. § 691 *et seq.*,⁷ that authorized the President to veto individual line items of spending legislation. Allowing the President to exercise a line item veto, the Court held, would allow “truncated versions” of bills passed by Congress to become law, a result at odds with the “‘finely wrought’ procedure that the Framers designated.” 524 U.S. at 440. “If the Line Item Veto Act were valid,” the Court explained,

⁷ Line Item Veto Act, Pub. L. 104-130, 110 Stat. 1200 (1996), *invalidated by Clinton v. State of New York*, 524 U.S. 417 (1998).

it would authorize the President to create a different law—one whose text was not voted on by either House of Congress or presented to the President for signature. Something that might be known as “Public Law 105–33 as modified by the President” may or may not be desirable, but it is surely not a document that may “become a law” pursuant to the procedures designed by the Framers of Article I, § 7, of the Constitution.

Id. at 448–49.

Clinton may not be distinguished on the theory that rescission of the CPI cap would amount merely to a case-specific suspension or waiver of the cap, or a revision of a statutory table of examples. *Cf. Marshall Field & Co. v. Clark*, 143 U.S. 649 (1892); *Republic of Iraq v. Beatty*, 556 U.S. 848, 861 (2009); *Terran v. Sec’y of HHS*, 195 F.3d 1302, 1307–08, 1312–14 (Fed. Cir. 1999); *Defenders of Wildlife v. Chertoff*, 527 F. Supp. 2d 119, 124–26 (D.D.C. 2007). The suspensions, waivers, and revisions upheld in those cases were temporary, peripheral or limited adjustments to a larger statutory scheme. Rescission of the CPI cap, by contrast, would nullify the constraint that the Commission has acknowledged is the “central” and “indispensable” core of PAEA. Such rescission would moot and therefore repeal the congressionally mandated Exigency Provision. *See supra* p.5. Eliminating the CPI cap would go beyond pruning the leaves, twigs, or peripheral branches of PAEA; it would uproot the law at its very trunk and taproot.

Furthermore, the suspensions, waivers and revisions upheld in *Marshall Field*, *Republic of Iraq*, *Defenders of Wildlife*, and *Terran* were all found to “execut[e] the policy that Congress had embodied in the statute,” *Clinton*, 524 U.S. at 444; *accord Republic of Iraq*, 556 U.S. at 861 (the statutory “proviso expressly allowed the President to render certain statutes inapplicable”) (emphasis in original). Section 3622(d)(1)(E), which authorizes the Commission to approve above-CPI increases in certain “extraordinary” or “exceptional” circumstances, is an example of a

constitutionally-permissible suspension or waiver provision of this kind. By contrast, nothing in the language, structure, or history of PAEA implies, let alone states expressly, that the Commission is allowed to discard the CPI cap under Section 3622(d)(3). Order No. 547 at 10–13, 49–50.

Wholesale repeal or modification of the heart of PAEA would additionally infringe upon the powers of Congress, as the OIG has recognized. *See supra* note 8 and accompanying text. The non-delegation doctrine recognizes that the Constitution gives Congress the power to legislate, and Congress may not delegate that power to administrative agencies through standardless delegations of authority. *See, e.g., Mistretta v. United States*, 488 U.S. 361, 371–79 (1989); *see also Panama Ref. Co.*, 293 U.S. at 430; *A.L.A. Schechter Poultry Corp.*, 295 U.S. at 529–31.

Allowing the Commission to eliminate or modify the congressionally-established CPI cap as part of its ten-year review, with no guidance or limits as to what alternative system can replace it, would entail just such a standardless delegation. Congress could not have intended to provide the Commission with unfettered discretion to repeal every substantive ratemaking provision of PAEA through a regulatory process—let alone effected this standardless delegation through an amendment that was added at the last moment to a substitute bill that was signed by the President without Committee consideration or debate. Such revision would run counter to the intelligible standards Congress set through its mandatory requirements in Section 3622.

By contrast, interpreting Section 3622(d)(3) as requiring the Commission to review its regulations and amend or provide for alternative regulatory schemes *within* the mandatory framework set by Congress provides an “intelligible principle” to narrow the agency’s discretion and thus avoids the serious constitutional problem posed by the broader interpretation of Section

3622(d)(3) that administrative rescission of the CPI cap would require. “A construction of the statute that avoids [an] open-ended grant should certainly be favored.” *Indus. Union Dep’t v. Am. Petroleum Inst.*, 448 U.S. 607, 646 (1980) (plurality opinion); *see also Nat’l Cable Television Ass’n, Inc. v. United States*, 415 U.S. 336, 342 (1974) (construing statute to avoid non-delegation question); *cf. Mistretta*, 488 U.S. at 373 n.7 (“In recent years, our application of the nondelegation doctrine principally has been limited to . . . giving narrow constructions to statutory delegations that might otherwise be thought to be unconstitutional.”).

The mandatory requirements and limitations of Section 3622, discussed *supra* Section I, form the basis for this guidance. The more reasonable and Constitutionally-sound analysis indicates that Section 3622(d)(3) requires the Commission to review the system to regulate rates that it set up through Congress’s guidance, and revise only those aspects of the system that Congress left to the Commission’s discretion as needed to meet the objectives set by Congress. The “heart” of the system, the CPI rate cap, may only be amended through Congressional action.

CONCLUSION

For these reasons, the Commission can and must declare that its 2017 Review under Section 3622(d) (3) will not result in any alteration to Sections 3622(d)(1) and (2) or Section 3622(e). While formal initiation of the review will not occur for several years, the Commission should resolve this issue now, so that when the review is commenced the Commission and all interested parties are focused on the matters that do lie within the Commission’s discretion, thereby enabling the review process to produce results which advance the purposes of PAEA.

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Association of Marketing Service Providers
Direct Marketing Association
EMA
MPA-The Association of Magazine Media
National Association of Advertising Distributors, Inc.
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